

School of Futures – Interactive Brokers

Session 2: Market Participants

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February 27, 2014

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Futures trading is not suitable for all investors, and involves the risk of loss. Futures are a leveraged investment, and because only a percentage of a contract's value is required to trade, it is possible to lose more than the amount of money deposited for a futures position. Therefore, traders should only use funds that they can afford to lose without affecting their lifestyles. And only a portion of those funds should be devoted to any one trade because they cannot expect to profit on every trade. All references to options refer to options on futures.

Swaps trading is not suitable for all investors, involves the risk of loss and should only be undertaken by investors who are ECPs within the meaning of section 1(a)12 of the Commodity Exchange Act. Swaps are a leveraged investment, and because only a percentage of a contract's value is required to trade, it is possible to lose more than the amount of money deposited for a swaps position. Therefore, traders should only use funds that they can afford to lose without affecting their lifestyles. And only a portion of those funds should be devoted to any one trade because they cannot expect to profit on every trade.

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What Types of Traders are There?

Hedgers vs. Speculators

- Hedgers
 - Have positions in a Cash (Physical) Market
 - Tend to be risk adverse
 - Accept it – it's always there
 - Manage it – many tools to deal with it
 - Hedgers have an interest in either buying or selling the physical or underlying commodity at a later date
 - Long Hedgers have the risk of rising prices
 - Short Hedgers have the risk of falling prices
- *Important Note*
 - *If you don't manage risk, then.....you are ASSUMING risk*
 - *If you are assuming risk, then.....you are SPECULATING*
- Speculators
 - Do not have positions in a Cash (Physical) Market
 - Like Price Risk for profit “potential”
 - Look for price volatility – trading opportunities may exist where risk exists

Who else is a market participant?

- Individual Traders
- Portfolio Managers
- Proprietary Trading Firms
- Hedge Funds
- Market Makers



Hedger's Profitability

Revenue – Costs = Profitability

- Increase profits by
 - Increasing revenues
 - Lowering costs
- Control profits by
 - Improve planning
 - Improved price management



Speculator's Trading Rules

Buy Low and Later Sell High

or

Sell High and Later Buy Low

Key to Successful Trading = **Timing**



Greater the Volatility....then

Greater the Risk....then

Greater the Need for Hedgers to Trade and

Greater the Opportunities for Specs to Trade

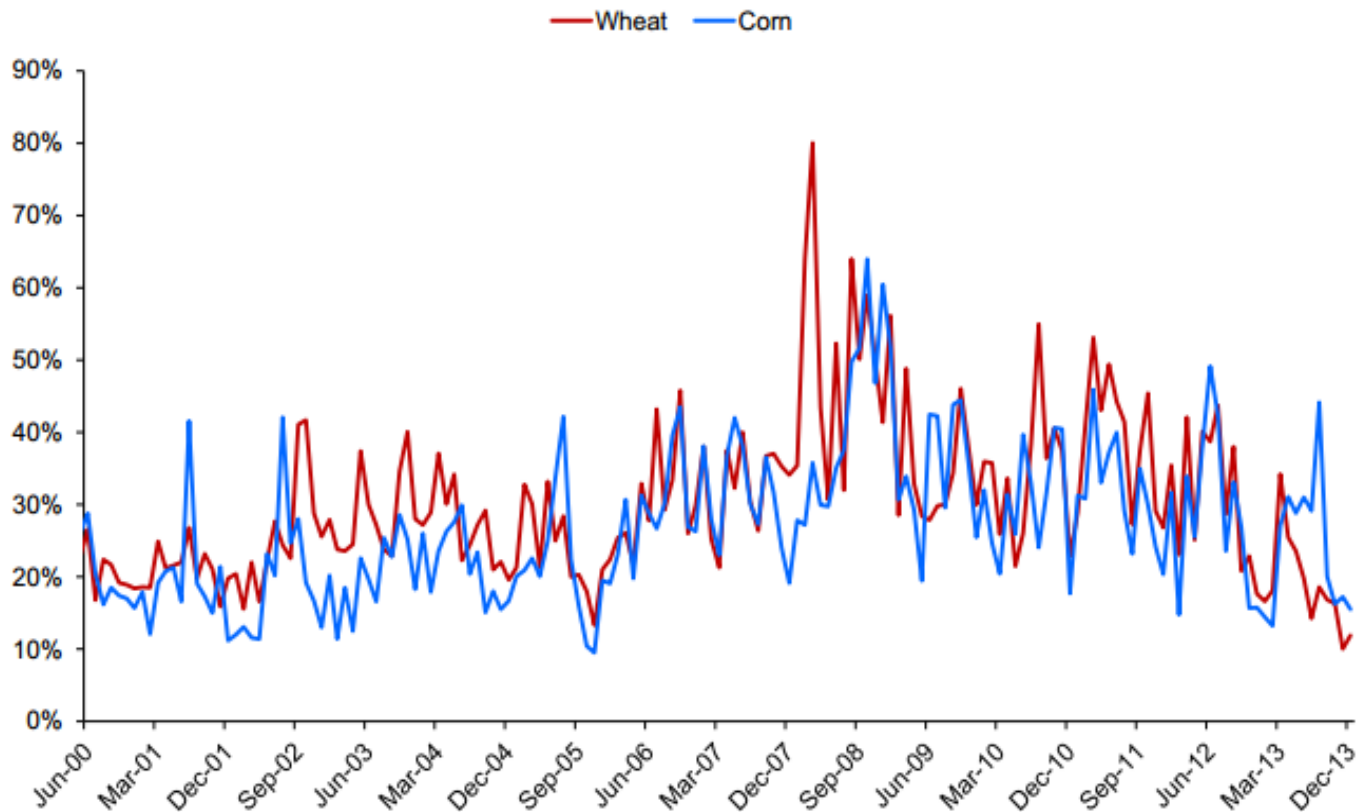
The Greater the Volume

Then.....**IT'S ALL ABOUT RISK!**

Corn and Wheat Volatility

Risk or Opportunity

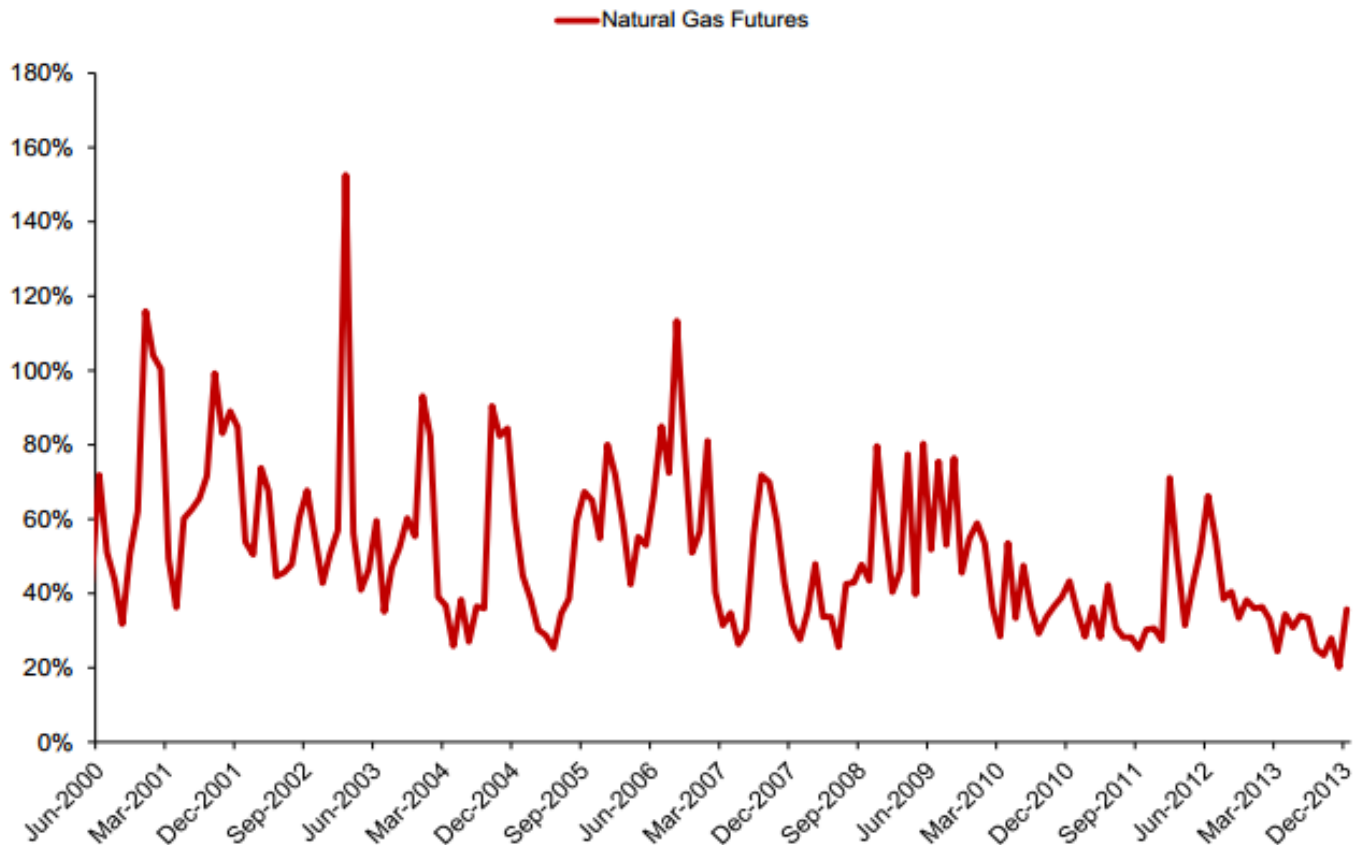
Corn and Wheat Monthly Historical Volatility - Spot Month



Natural Gas Volatility

Risk or Opportunity

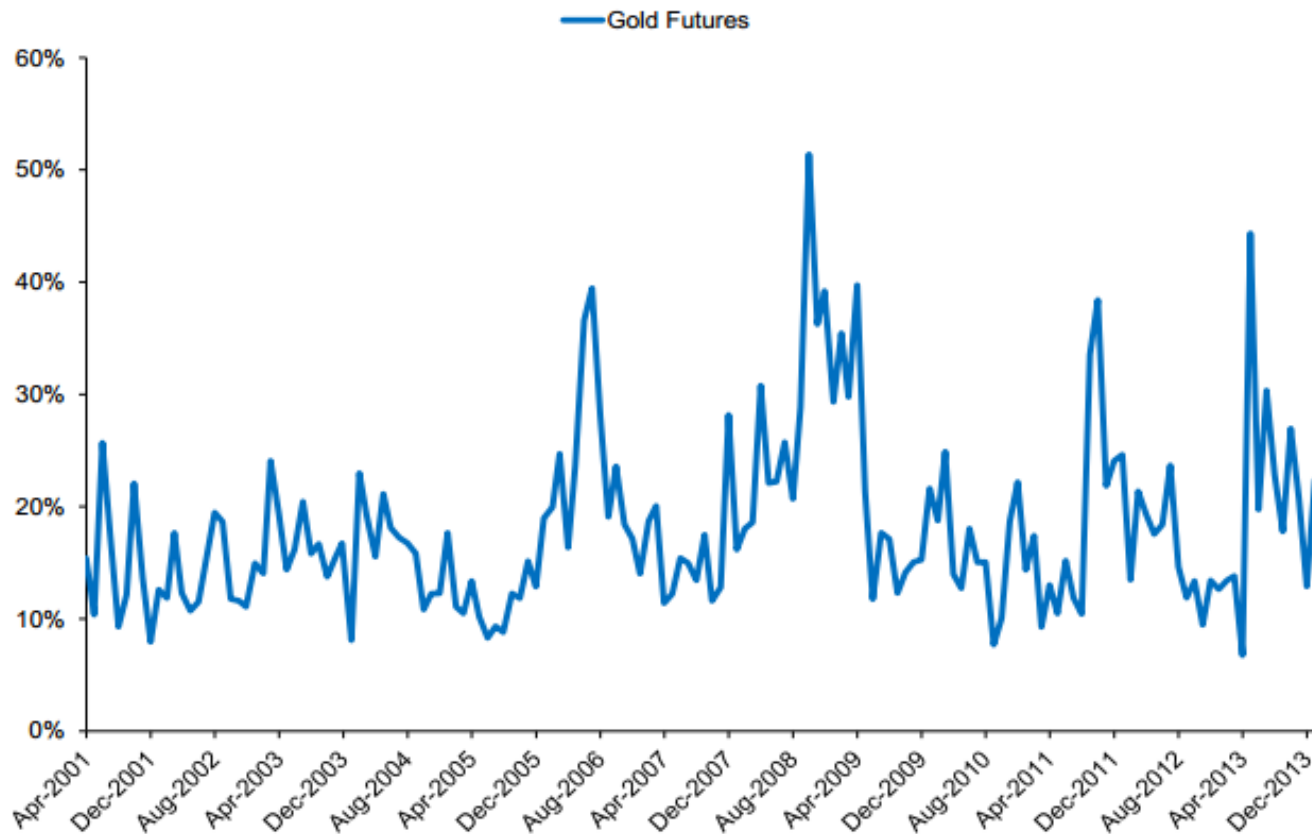
Natural Gas Futures - 20-Day Historical Volatility



Metals Complex Volatility

Risk or Opportunity

Gold Futures - Spot Month - 20-Day Historical Volatility



Speculation Concept

Speculation

Benefits to the Marketplace

- Willingness to assume market risk
 - Facilitates Risk Transfer Process
- Market Liquidity
 - Enhances pricing efficiency
 - Dampens market extremes
 - Improves back month participation and efficiency



Speculation

Benefits to the Individual

- Profit potential
 - Buy Low then Sell high or Sell high and Buy Low
- Profit on changes in price or price relationships (spreads)
- Market liquidity
 - Enhances pricing efficiency
 - Ability to enter and exit positions at efficient prices
- Financial Integrity
 - CME Clearing is buyer to every seller and seller to every buyer
- Variety of strategies
 - Different strategies with different profit/loss potential
- Leverage
 - Use of relatively small amount of capital to manage a larger valued position



Speculators are classified in many ways

- Position size
 - Individual
 - Proprietary Trader
 - Funds
- Time with a position
 - Scalper
 - Day trader
 - Position trader
- Type of Positions
 - Outrights
 - Spreads
- Type of Analysis
 - Fundamental
 - Technical
 - Gut opinion
 - Combination of the above



Speculative Futures Strategies

Long Futures

| | |
|--------------------------|---|
| Market Opinion: | Bullish |
| Position: | Buy a Futures Contract |
| Profit Potential: | Unlimited |
| Loss Potential: | Unlimited |
| Breakeven: | Futures price at which a position was initiated |
| Margin required: | Yes |
| Delta: | +1.00 |

Long Futures

Example Part 1

| | |
|----------------------------------|---|
| Current Futures Position: | Long 1 December Crude Oil @\$101.00 |
| Crude Oil Contract Size: | 1,000 barrels |
| Crude Oil Tick Size: | \$.01/barrel or \$10/per contract (1,000 barrels) |
| Margin Requirement: | \$7,560 per contract (1,000 barrels) |

| | |
|--------------------|--|
| Scenario 1: | Offset (Sell) December Crude Oil @\$102.00 |
| Profit: | \$_____ or \$_____ per contract (\$1.00 X 1,000 barrels) |
| ROI: | _____ % = (Profit/margin requirement → \$_____/ \$7,560) |

| | |
|--------------------|---|
| Scenario 2: | Offset (Sell) December Crude Oil @\$100.50 |
| Loss: | \$_____ or \$_____ per contract (\$_____ X 1,000 barrels) |

Long Futures

Example Part 2

| | |
|----------------------------------|---|
| Current Futures Position: | Long 1 December Crude Oil @\$101.00 |
| Crude Oil Contract Size: | 1,000 barrels |
| Crude Oil Tick Size: | \$.01/barrel or \$10/per contract (1,000 barrels) |
| Margin Requirement: | \$7,560 per contract (1,000 barrels) |

| | |
|--------------------|--|
| Scenario 1: | Offset (Sell) December Crude Oil @\$102.00 |
| Profit: | <u>\$1.00/barrel</u> or <u>\$1,000</u> per contract (<u>\$1.00</u> X 1,000 barrels) |
| ROI: | <u>13.22%</u> = (Profit/margin requirement → <u>\$1,000</u> /\$7,560) |

| | |
|--------------------|--|
| Scenario 2: | Offset (Sell) December Crude Oil @\$100.50 |
| Loss: | <u>\$0.50/barrel</u> or <u>\$500</u> per contract (<u>\$0.50</u> X 1,000 barrels) |

Short Futures

| | |
|--------------------------|---|
| Market Opinion: | Bearish |
| Position: | Sell a Futures Contract |
| Profit Potential: | Unlimited |
| Loss Potential: | Unlimited |
| Breakeven: | Futures price at which a position was initiated |
| Margin required: | Yes |
| Delta: | -1.00 |

Short Futures

Example Part 1

| | |
|----------------------------------|--|
| Current Futures Position: | Short 1 October Gold @\$1670 |
| Crude Oil Contract Size: | 100 troy ounces |
| Crude Oil Tick Size: | \$.10/oz. or \$10/per contract (100 troy ounces) |
| Margin Requirement: | \$11,475 per contract (100 troy ounces) |

| | |
|--------------------|---|
| Scenario 1: | Offset (Buy) October Gold @\$1640 |
| Profit: | \$_____ or \$_____ per contract (\$__ X 100 troy ounces) |
| ROI: | _____ % = (Profit/margin requirement → \$_____/ \$11,475) |

| | |
|--------------------|---|
| Scenario 2: | Offset (Buy) October Gold @\$1675 |
| Loss: | \$_____ or \$_____ per contract (\$_ X 100 troy ounces) |

Short Futures

Example Part 2

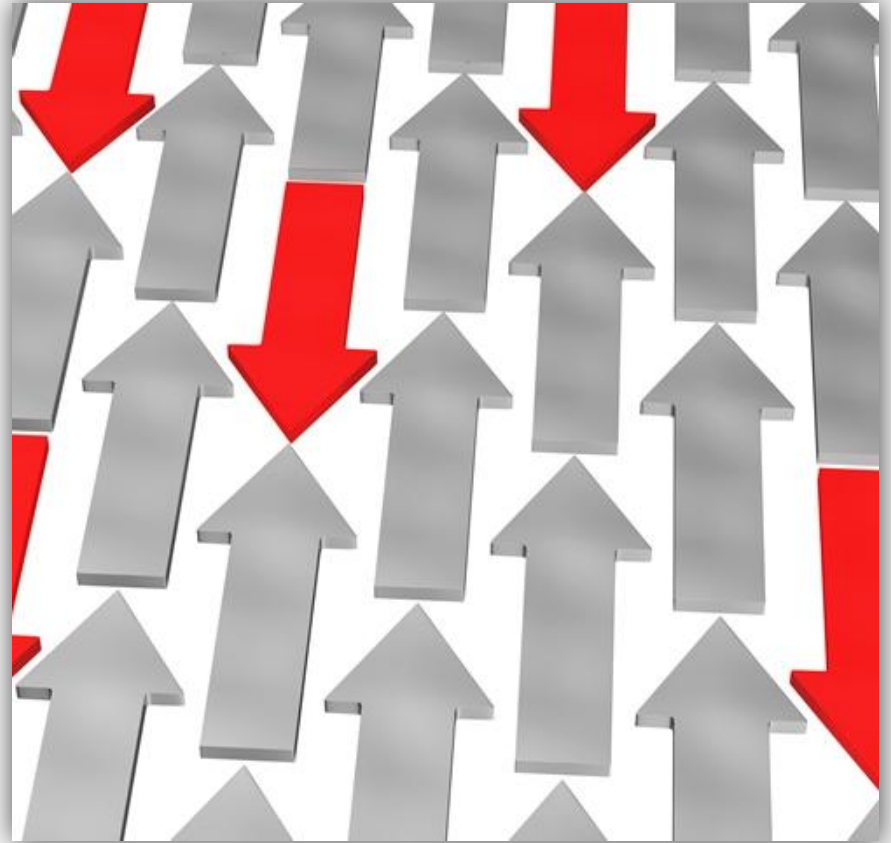
| | |
|----------------------------------|--|
| Current Futures Position: | Short 1 October Gold @\$1670 |
| Crude Oil Contract Size: | 100 troy ounces |
| Crude Oil Tick Size: | \$.10/oz. or \$10/per contract (100 troy ounces) |
| Margin Requirement: | \$11,475 per contract (100 troy ounces) |

| | |
|--------------------|---|
| Scenario 1: | Offset (Buy) October Gold @\$1640 |
| Profit: | <u>\$30/oz.</u> or <u>\$3,000</u> per contract (<u>\$30</u> X 100 troy ounces) |
| ROI: | <u>26.10%</u> = (Profit/margin requirement → <u>\$3,000</u> /\$11,475) |

| | |
|--------------------|---|
| Scenario 2: | Offset (Buy) October Gold @\$1675 |
| Loss: | <u>\$5/oz.</u> or <u>\$500</u> per contract (<u>\$5</u> X 100 troy ounces) |

Trading Opportunities

- Depending on your risk-reward profile, there should be a strategy to meet your needs
 - Seasonal
 - Volatility Related
 - Bullish or Bearish
 - Outrights
 - Spreads



Introduction to Spreading

Spreading

Characteristics and Benefits

- Spread Defined
 - Noun: relationship between two or more contracts
 - Verb: simultaneous purchase of one contract and the sale of another
- Role or function of spreaders:
 - Hedge transaction – Managing firm’s risk exposure (roll risk)
 - Speculative transaction – Profit potential
- Benefits to the spreader
 - Lower margin requirements; generally less risk
 - Profit “potential” regardless of price direction
 - Increases number of strategies
- Benefits to the marketplace
 - Enhances liquidity (especially in deferred months)
 - Restores “normalcy”

Spreading

Spread Execution



Spreading

Bull and Bear Spread Execution and Expectations

- Bull Spread Execution
 - Buy Nearby Contract and Sell Deferred Contract
- Bull Spread Expectations
 - **Nearby Contract** gains more than **Deferred Contract** or **Deferred Contract** declines more than **Nearby Contract**
 - More positive spread or less negative spread
 - Buy spread @+20 and later sell @+30
 - Buy spread @-15 and later sell @-10
- Bear Spread Execution
 - Sell Nearby Contract and Buy Deferred Contract
- Bear Spread Expectations
 - **Nearby Contract** declines more than **Deferred Contract** or **Deferred Contract** gains more than **Nearby Contract**
 - Less positive spread or more negative spread

Spreading

Types of Spreads

InterDelivery (IntraMarket) Spreads

- Same Commodity
- Same Exchange
- Different Months
 - Ex: March June 10 Year Treasury Note

InterMarket Spreads

- Same Commodity
- Same Month
- Different Exchange
 - Ex: COMEX vs. LME Gold

InterCommodity Spreads

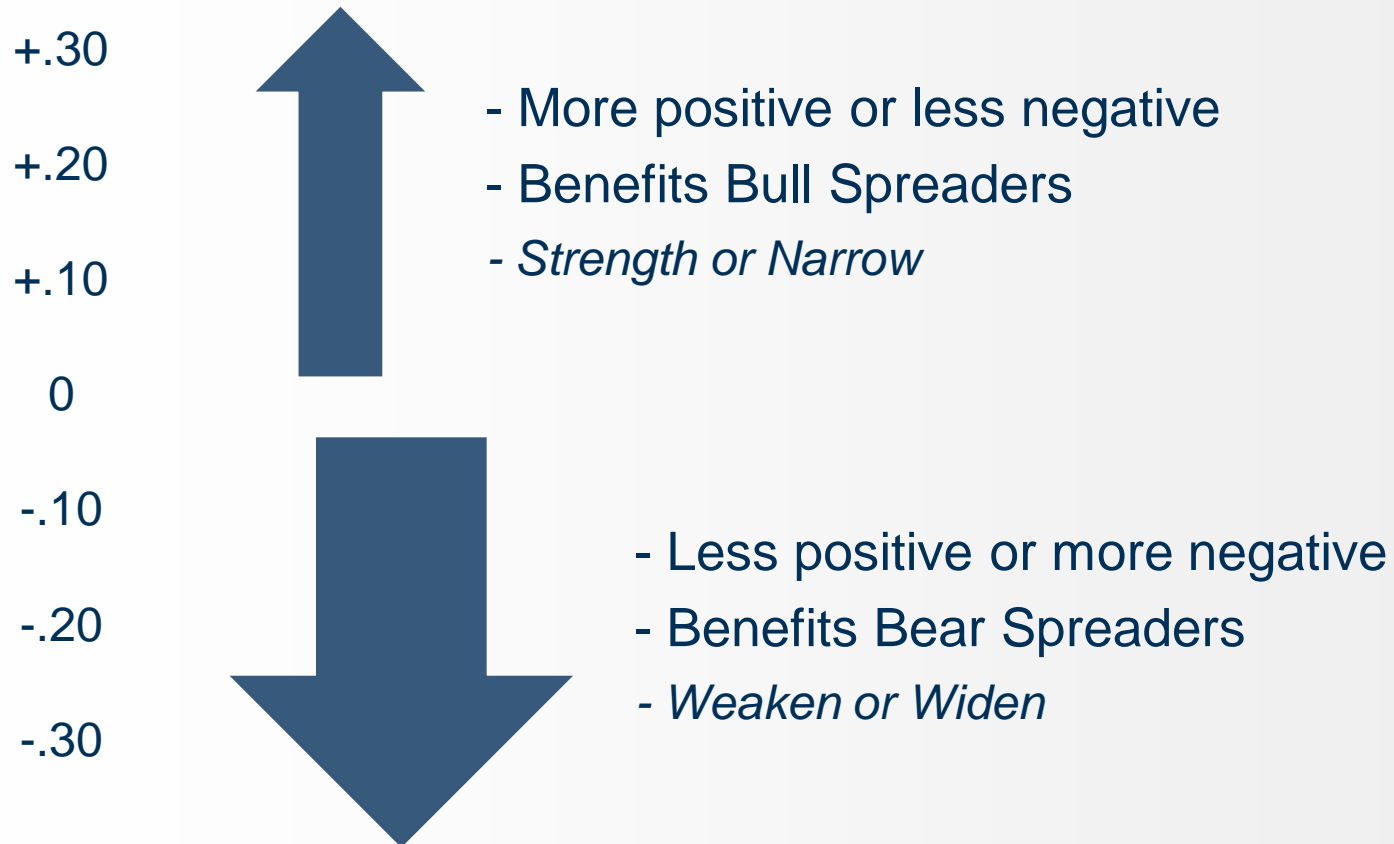
- Same Month
- Different but Related Commodities
 - Ex: December Gold and December Silver

Commodity Product Spreads

- Same Month
- Product vs. By-Product
 - Ex: Crack Spread: March Crude Oil, Heating Oil or Gasoline

Spreading

Movement of Spreads



Note: Spread terminology may vary by product/complex

Hedging

Hedging

Long and Short Futures Hedges

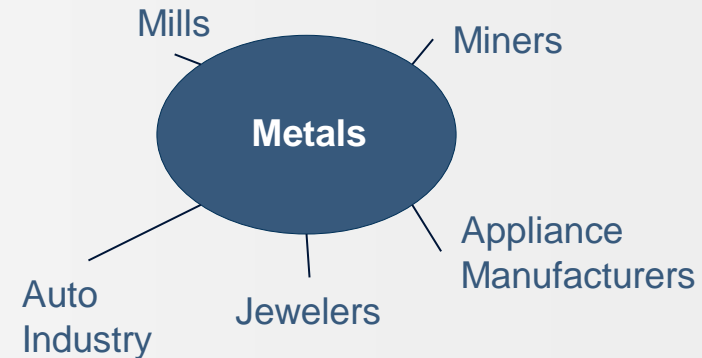
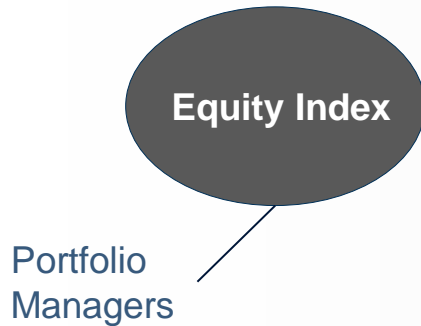
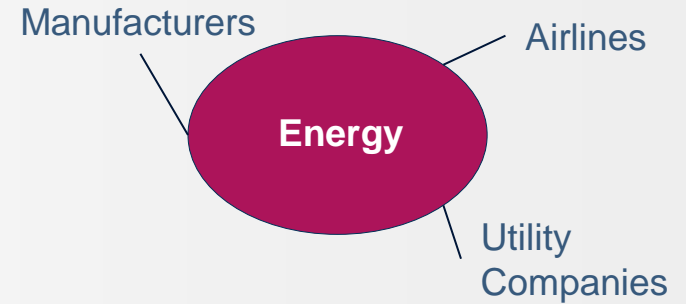
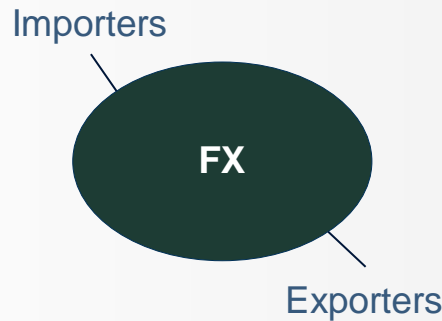
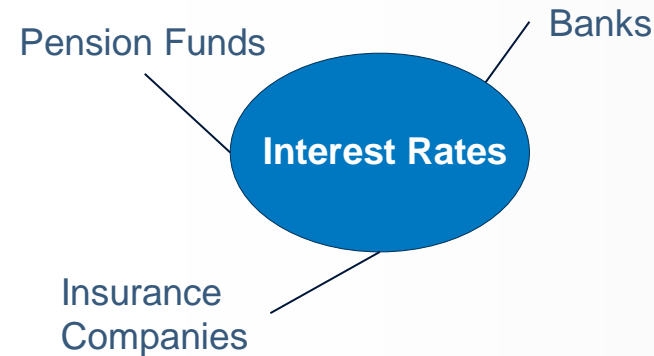
- Long Futures Hedge
 - Initiation of a **long (buy)** position in futures which is a temporary substitute for the eventual **purchase** of a commodity in your local market
- Short Futures Hedge
 - Initiation of a **short (sell)** position in futures which is a temporary substitute for the eventual **sale** of a commodity in your local market



Note: The short hedge can also be used to protect inventory value.

Who are Hedgers?

Hedgers in other complexes on both the buy & sell side



Hedging

Summary

- Take advantage of current purchase and sale prices
- Protect against adverse prices
- Assists with planning & budgets
- Protects inventory value
- Not tied to a specific counterparty (buyer or seller)
- Financial integrity of CME Clearing

Commitment of Traders Report

Released Every Friday @ 3:30pm Eastern Time by the Commodity Futures Trading Commission (CFTC)

Commitment of Traders Report (COT)

Why this report?

- The Commitments of Traders reports provide a breakdown of *open interest* for futures markets
- Open Interest is the total number of futures contracts that are not closed or delivered on a particular day.
- Many speculative traders use the Commitments of Traders report to help them decide whether or not to take a long or short position
- The report provides a breakdown of aggregate positions held by three different types of traders
 - Commercial traders
 - Non-commercial traders
 - Non reportable traders



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COMMITMENTS OF TRADERS

Commitments of Traders

The Commitments of Traders (COT) reports provide a breakdown of each Tuesday's open interest for markets in which 20 or more traders hold positions equal to or above the reporting levels established by the CFTC.

Please see the official [Release Schedule](#) for a calendar of release dates.

Reports are available in both a short and long format. The short report shows open interest separately by reportable and nonreportable positions. For reportable positions, additional data is provided for commercial and non-commercial holdings, spreading, changes from the previous report, percents of open interest by category, and numbers of traders.


The long report, in addition to the information in the short report, groups the data by crop year, where appropriate, and shows the concentration of positions held by the largest four and eight traders.

Supplemental reports show aggregate futures and option positions of Noncommercial, Commercial, and Index Traders in 12 selected agricultural commodities.

RELATED LINKS

- [Large Trader Reporting Program](#)
- [Speculative Limits](#)

SEE ALSO:



[CFTC's Commitment to Open Government](#)

[CFTC Transparency](#)

JAPANESE YEN - CHICAGO MERCANTILE EXCHANGE
 Commitments of Traders - Futures Only, January 21, 2014

Code-097741

| | : Total : | : Reportable Positions : | | | | | | : Nonreportable Positions : | | |
|--------|--------------|--|--------------------|-----------------------|----------------|-----------------------|-----------|-----------------------------|----------|-----------|
| | | : Open : | : Non-Commercial : | | : Commercial : | | : Total : | | : Long : | : Short : |
| | : Interest : | : Long : | : Short : | : Spreading: | : Long : | : Short : | : Long : | : Short : | : Long : | : Short : |
| | | : (CONTRACTS OF JPY 12,500,000) : | | | | | | | | |
| All : | 217,548: | 13,128 | 128,089 | 2,860 | 186,273 | 38,501 | 202,261 | 169,450: | 15,287 | 48,098 |
| Old : | 217,548: | 13,128 | 128,089 | 2,860 | 186,273 | 38,501 | 202,261 | 169,450: | 15,287 | 48,098 |
| Other: | 0: | 0 | 0 | 0 | 0 | 0 | 0 | 0: | 0 | 0 |
| | | : Changes in Commitments from: January 14, 2014 : | | | | | | | | |
| | -776: | 2,374 | -731 | -660 | -2,523 | 2,009 | -809 | 618: | 33 | -1,394 |
| | | : Percent of Open Interest Represented by Each Category of Trader : | | | | | | | | |
| All : | 100.0: | 6.0 | 58.9 | 1.3 | 85.6 | 17.7 | 93.0 | 77.9: | 7.0 | 22.1 |
| Old : | 100.0: | 6.0 | 58.9 | 1.3 | 85.6 | 17.7 | 93.0 | 77.9: | 7.0 | 22.1 |
| Other: | 100.0: | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0: | 0.0 | 0.0 |
| | | : # Traders : Number of Traders in Each Category : | | | | | | | | |
| All : | 138: | 22 | 69 | 9 | 24 | 31 | 51 | 104: | | |
| Old : | 138: | 22 | 69 | 9 | 24 | 31 | 51 | 104: | | |
| Other: | 0: | 0 | 0 | 0 | 0 | 0 | 0 | 0: | | |
| | | : Percent of Open Interest Held by the Indicated Number of the Largest Traders : | | | | | | | | |
| | | : By Gross Position : | | | | : By Net Position : | | | | |
| | | : 4 or Less Traders : | | : 8 or Less Traders : | | : 4 or Less Traders : | | : 8 or Less Traders : | | |
| | | : Long: | : Short | : Long | : Short: | : Long | : Short | : Long | : Short | |
| All : | | 53.0 | 27.7 | 72.3 | 38.3 | 52.8 | 27.6 | 72.1 | 37.9 | |
| Old : | | 53.0 | 27.7 | 72.3 | 38.3 | 52.8 | 27.6 | 72.1 | 37.9 | |
| Other: | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |

E-MINI S&P 500 STOCK INDEX - CHICAGO MERCANTILE EXCHANGE
 Commitments of Traders - Futures Only, January 21, 2014

Code-13874A

| | Reportable Positions | | | | | | | | | | Nonreportable Positions | |
|--|----------------------|---------|----------------------|-----------|-----------------|------------------|------------|-------------|---------|---------|-------------------------|-------|
| | Open Interest | Long | Non-Commercial Short | Spreading | Commercial Long | Commercial Short | Total Long | Total Short | Long | Short | Long | Short |
| (\$50 X S&P 500 INDEX) | | | | | | | | | | | | |
| All | 2,871,444 | 469,764 | 469,111 | 74,632 | 2,078,523 | 2,129,965 | 2,622,919 | 2,673,708 | 248,525 | 197,736 | | |
| Old | 2,871,444 | 469,764 | 469,111 | 74,632 | 2,078,523 | 2,129,965 | 2,622,919 | 2,673,708 | 248,525 | 197,736 | | |
| Other | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | | |
| Changes in Commitments from: January 14, 2014 | | | | | | | | | | | | |
| All | -14,067 | -60,075 | 37,418 | -9,977 | 47,611 | -20,254 | -22,441 | 7,187 | 8,374 | -21,254 | | |
| Percent of Open Interest Represented by Each Category of Trader | | | | | | | | | | | | |
| All | 100.0 | 16.4 | 16.3 | 2.6 | 72.4 | 74.2 | 91.3 | 93.1 | 8.7 | 6.9 | | |
| Old | 100.0 | 16.4 | 16.3 | 2.6 | 72.4 | 74.2 | 91.3 | 93.1 | 8.7 | 6.9 | | |
| Other | 100.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| Number of Traders in Each Category | | | | | | | | | | | | |
| All | 534 | 128 | 86 | 46 | 215 | 207 | 357 | 325 | | | | |
| Old | 534 | 128 | 86 | 46 | 215 | 207 | 357 | 325 | | | | |
| Other | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | | | | |
| Percent of Open Interest Held by the Indicated Number of the Largest Traders | | | | | | | | | | | | |
| By Gross Position | | | | | | | | | | | | |
| By Net Position | | | | | | | | | | | | |
| 4 or Less Traders 8 or Less Traders 4 or Less Traders 8 or Less Traders | | | | | | | | | | | | |
| Long: Short Long Short: Long Short Long Short | | | | | | | | | | | | |
| All | 17.7 | 19.5 | 27.1 | 29.0 | 15.4 | 19.4 | 24.0 | 28.7 | | | | |
| Old | 17.7 | 19.5 | 27.1 | 29.0 | 15.4 | 19.4 | 24.0 | 28.7 | | | | |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | | | |

School of Futures

Session 3: An Introduction to the Equity Index Complex

David Gibbs, CME Education and Development
March 27, 2014 @ 12:00pm Eastern Time

Thank you

Pete Mulmat

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