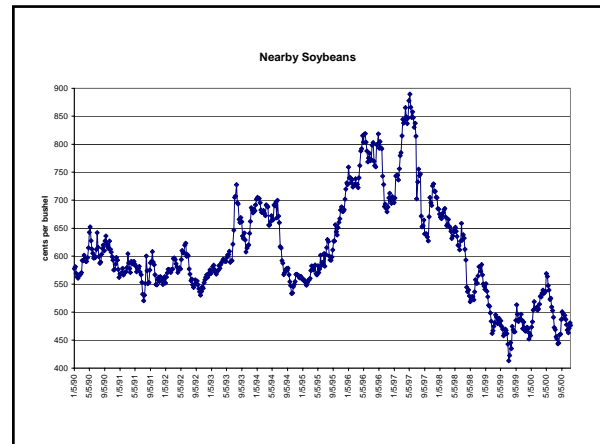


Functions of the Futures Market

- Price discovery:
Price action in the futures market is transparent. All prices are publicly reported as soon as a transaction takes place.
- Price risk management:
Futures markets are used to protect against price risk in cash markets.



Two Kinds of Traders

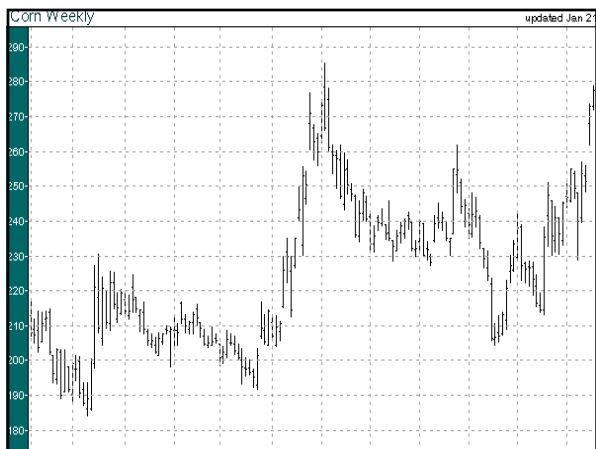
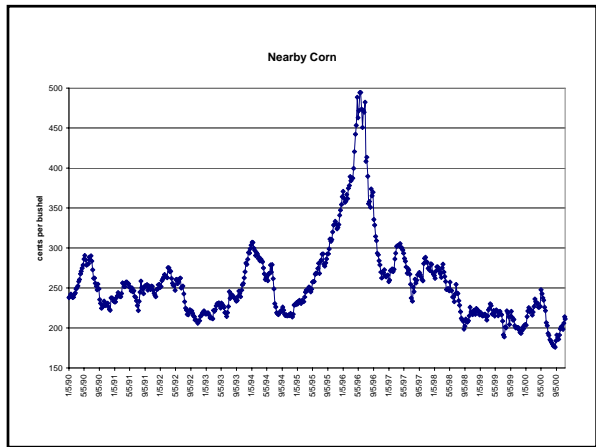
- Speculators
Care about futures prices, and try to profit as futures prices change. Often a pretty short planning horizon.
- Hedgers
Care about relative prices. Look for price protection by developing a position where losses in one market are offset by gains in another market.



FUTURES CONTRACT

- Legally binding commitment to make or take delivery of some commodity on a predetermined date at a negotiated price
- Everything except price is standardized:
 - Quality
 - Quantity
 - Delivery location
 - Delivery date





How are grain prices determined?

LOCAL ELEVATOR:

Grade Grain
Condition Grain
Store Grain
Reveal the first public price for grain

SUBTERMINAL ELEVATOR:

Linked to local elevator by rail, barge, or truck
Often do not buy directly from farmers
Major function is to concentrate grain into large shipments
Reveal second public price for grain.
Basically the local elevator price plus transportation and handling costs.

TERMINAL ELEVATOR:

Sell to export markets and processors. Do not buy from farmers.
Reveal third public price for grain.
Sub-terminal price plus transportation and handling costs.

EXPORT TERMINAL ELEVATORS:

Very concentrated industry. Over half of the U.S. export capacity is owned by Cargill, Bunge, and Louis Dreyfus.
Offer the export price to compete in the international market.

Date	Price per Bushel	Action	Margin Action	Account Balance
		Initial margin = \$500 Maintenance margin = \$350		
17-Jan	\$2.50	Buy July com	Deposit \$500	\$500
18-Jan	\$2.48			\$400
19-Jan	\$2.46			\$300
			Margin Call \$200	\$500
20-Jan	\$2.47			\$550
21-Jan	\$2.40			\$200
			Margin Call \$300	\$500
24-Jan	\$2.43			\$660
25-Jan	\$2.45			\$750
26-Jan	\$2.49			\$850
			Withdraw \$450	\$500
27-Jan	\$2.51			\$600
28-Jan	\$2.55	Sell July com		\$800

Futures Market

- Sends price signals to the entire system
- Actively used at all levels of the grain market chain EXCEPT the farm
- Is unique in its application of financial leverage

Margin Management

- Individual traders margin accounts are managed by their brokers.
- The brokers are held accountable for their customers positions in the futures markets.
- Minimum margins are set by the exchange. Brokers may require larger margins from customers.
- Brokers may require traders to post more than their margin requirement in their accounts.
- Margin accounts do not earn interest. However, money can often be moved between a margin account and a money market account

FUTURES CONTRACTS

- Traded on margin
- Marked to market daily
- Allow for offsetting legal obligation

Market Participants

- Floor Brokers:
 - Largest group of traders in the pits
 - Fill orders for outside speculators or hedgers
 - Responsible for filling orders rapidly with little or no price concession
 - Some take orders from several firms, others specialize

- Professional Speculators:

- Mostly trade for their own account
- **Scalpers** – always presenting a bid and an offer, do not hold positions long and almost never have positions overnight, buy and sell constantly, MARKET MAKERS
- **Pit Traders** – Larger positions and hold for a longer period of time, typically do not hold positions over night, try to anticipate large orders
- **Floor Speculators** (day to day scalpers) – Take huge positions and hold for several days, POSITION TRADERS, often deal in multiple markets, deep pockets and can take or make delivery THUS WATCH CASH MARKETS

- Commodity Trade Advisor (CTA)

- Individual or corporation who advises others regarding trades
- Provide information for pay
- May advise or manage individual discretionary accounts, commodity pools, or FCM's
- CANNOT POOL INDIVIDUAL INVESTORS INTO A SINGLE ACCOUNT
- CTA's must register with the CFTC

- Non-professional Speculators

- General public – Largest single group of traders
- Place orders with account executives or associated persons at local brokerage houses
- Some make their own trading decisions, some trade on the advise of a broker
- Some join a club or commodity fund
- Typically hold:
 - » 25 – 30 percent of financial market positions
 - » 30 to 50 percent of grain positions

- Commodity Pool Operator (CPO)

- Solicits and pools together funds from several traders so risks and returns are shared
- Many pools hire a CTA for advise
- CPO's must register with the CFTC and the SEC

Facilitators of Public Trade

- Associated Parties:

- Futures Commission Merchant (FCM)
 - Firm or person soliciting outside orders
 - Brokers and account executives
 - Must register with the Commodity Futures Trading Commission
 - Certified attesting to their integrity