TRADING ASIA-PACIFIC FINANCIAL FUTURES MARKETS

WILL SLATYER & EDNA CAREW

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Will Slatyer and
Edna Carew
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Contents

1 Glossary of terms

Abbreviations

AFFM	Australian Financial Futures Market
AMEX	American Stock Exchange
AOM	Australian Options Market
ASX	Australian Stock Exchange
CBOE	Chicago Board Options Exchange
CBOT	Chicago Board of Trade
CME	Chicago Mercantile Exchange
Comex	Commodity Exchange of New York
CSCE	Coffee, Sugar & Cocoa Exchange
DTB	Deutsche Terminborse
EOE	European Options Exchange
Fox	London Futures and Options Exchange
KLCE	Kuala Lumpur Commodity Exchange
LIFFE	London International Financial Futures Exchange
LME	London Metals Exchange
LTOM	London Traded Options Market
MATIF	Marché à Terme International de France
MEFF	Mercado de Futuros Financieros
MONEP	Marché des Options Négociables de la Bourse de Paris
NZFOE	New Zealand Futures and Options Exchange
NYCE	New York Cotton Exchange
NYFE	New York Futures Exchange
NYMEX	New York Mercantile Exchange
OM	Stockholm Options Market
OMI	OM Iberica

OSE	Osaka Securities Exchange
PHLX	Philadelphia Stock Exchange
PSE	Pacific Stock Exchange
SFE	Sydney Futures Exchange
SIMEX	Singapore International Monetary Exchange
SOFFEX	Swiss Options and Financial Futures Exchange
TGE	Tokyo Grain Exchange
TIFFE	Tokyo International Financial Futures Exchange
TOCOM	Tokyo Commodity Exchange
TSE	Tokyo Stock Exchange

administrative guidance power and influence exercised by Japan's Ministry of Finance over financial markets and the business sector. This *gyosei shido* derives from a mix of traditional Japanese respect for officialdom and an informal power enjoyed by the ministry (but not the Bank of Japan) that enables it to move against those who do not cooperate.

alligator spread a US commodity trader's expression for a situation where the commission is so large that it 'eats' the client (chews up the client's cash).

All-Ordinaries index a stock exchange measure, this is an index of the market prices of more than 230 Australian companies listed on the Australian Stock Exchange (ASX). The market value of these companies totals about 95 per cent of domestic market capitalisation. The All-Ordinaries index is calculated continuously each day and is published daily. See **Dow Jones industrial average, Footsie, Nikkei index**

American option an option that is tradeable and can be exercised at any time up to the date it is due to expire. The options traded on the Sydney Futures Exchange are an example of an American option. See **European option**

American Stock Exchange located in Manhattan, New York, this exchange ranks in the top half-dozen US exchanges in terms of trading volume. It is estimated to have begun in business in the 1849 gold rush, and was known as the Curb Exchange until 1921, because trading took place outdoors, at the kerb (US curb). The American Stock Exchange trades small- and medium-sized companies' shares, whereas the New York Stock Exchange carries the big-name, mature companies. *Abbrev.* AMEX

anomaly in ordinary use a deviation, a departure from the accepted norm. Traders talk of anomalies in the yield curve when they mean imperfections in the curve—a departure from the conventional shape. Money can be made by astute traders who spot anomalies in the yield curve and take advantage of them. Anomalies can also emerge between markets, between securities, such as bills and bonds, and between time zones. See **arbitrage, yield curve**

appreciation the increase in the value of an asset or the increase in the value of a currency against other currencies.

APT see **automated pit trading**

arbitrage to take advantage of different rates, prices or conditions between different markets or maturities. Arbitragers—sometimes called 'arbitrageurs'—make the most of inconsistencies between prices in different markets, for example if a stock sells for a lower price in one market than in another, an arbitrager would buy it at the lower price and sell it at the higher. There is little risk involved.

Article 65 (of Japan's Securities Exchange Law) enacted after the Second World War, this is Japan's version of the US Glass Steagall Act. It prohibits Japanese commercial banks from underwriting, dealing, broking and distributing securities other than government, local government and government-guaranteed bonds and debentures. Securities companies are also banned from domestically taking deposits or making loans. As is the case with the Glass Steagall Act, Article 65 is being watered down.

Asian currency unit the department of a Singapore bank which is licensed by the Monetary Authority of Singapore to deal in external currencies, but is restricted in what it can do in the Singapore domestic currency market. *Abbrev.* ACU. See **Monetary Authority of Singapore**

Association of International Bond Dealers a Zurich-based professional association, established in 1969, with more than 350 member institutions. It recommends rules and regulations for dealing, and collates and publishes quotes and yields for the eurobond market. *Abbrev.* AIDB. See **eurobonds, euromarkets**

ASX see **Australian Stock Exchange**

at-best order a futures trader may execute an at-best order at a price that he or she believes to be the best price that can be achieved in the current market. This type of order gives the trader ultimate discretion. See **order with discretion**

at call funds placed at call can be withdrawn on demand or without notice. In the short-term money market, funds can be placed at 11am call or 24-hour notice of call, as distinct from being fixed for a specified period.

at market see **market order**

at par see **par value**

ATS see **automated trading system**

at the money a term used in option trading to describe an exercise (or strike) price that is at or about current market levels. See **in the money, out of the money**

Australian Stock Exchange a national organisation that began operating in 1987 as the replacement of Australia's state-based exchanges. Its arrival signalled the first stage in the development of electronically traded share markets. *Abbrev.* **ASX**

authorised dealer (in the short-term money market) one of the dealer companies which constitute the 'official' short-term money market in Australia. The authorised dealers have a special relationship with the Reserve Bank which includes a lender-of-last-resort facility as a backstop for that market. They began life in their present form in 1959 and were established primarily to stimulate trading in government securities and to provide safe investment opportunities for ultra-short-term cash surpluses. The authorised dealers broadly equate to the US primary dealers and the UK discount houses.

automated pit trading the London International Financial Futures Exchange (LIFFE)'s electronic trading system, initially only to be used after hours but recognised as likely ultimately to replace floor trading. *Abbrev.* **APT**

automated trading system a computerised trading system that links all major centres in a country. *Abbrev.* **ATS**

B/A see **banker's acceptance**

back bond the security created when a debt warrant is converted. Also **virgin bond**

back-to-back in the futures market, back-to-back describes an equal number of bought and sold contracts held by one trader in one month. The term is also used to refer to offsetting loans, often made in one currency in one country against a loan in another currency in another country.

backwardation this describes a futures market situation where prices are higher in the nearer delivery months than in the distant months. For example, if the SFE share-price index futures for a delivery in March stood at 1645.0 and for a June delivery at 1640.0 then the backwardation for three months to March would be 50 points. The opposite of backwardation is contango. Also **inverted market.** See **contango**

bank-accepted bill of exchange a bill of exchange on which a bank's name appears as the acceptor—ie, the bank has the primary liability to pay the amount of money due on the bill's maturity date to the holder of the bill. See **bank bill of exchange, bill of exchange**

bank bill of exchange a bill of exchange on which the name of a bank appears, either as acceptor or endorser. Where the bank is the acceptor, the bill ranks as a bank-accepted bill; where the bank has endorsed the bill on the back, either through buying the bill in the market or for a fee to raise the bill's status, it ranks as a bank-endorsed bill of exchange. See **bill of exchange**

Bank for International Settlements a body organised as a commercial bank, with publicly held shares and 80 per cent held by central banks; shareholders, though, have no say in the running of the bank. The BIS is immune from government interference and taxes, under an international treaty. It was established in 1930, originally to facilitate the payments to countries still owed First World War reparations by Germany. Since then it has evolved into a central bank for many of the world's central banks. Countries regularly represented at the BIS meetings are those belonging to the IMF's Group of Ten. Other countries represented from time to time include the remaining members of the European Economic Community, some Eastern European countries and other countries such as Saudi Arabia, as required. The BIS takes deposits and makes loans and plays a role in international finance, especially when speculative transactions are involved. Directors of the BIS hold a monthly meeting at the bank's head office in Basle, Switzerland. Its board includes representatives of the central banks of the UK, France, West Germany, Belgium, Italy, Switzerland, the Netherlands and Sweden. *Abbrev.* BIS

Bank of England the UK central bank, founded in 1694 and affectionately known as the Old Lady of Threadneedle Street (from its location in that street in the City of London).

Bank of Japan Japan's central bank, equivalent of Australia's and New Zealand's Reserve Banks, the US's Federal Reserve and the UK's Bank of England. See **window guidance**. *Abbrev.* BoJ

bank paper see **paper**

banker's acceptance the US version of a bank-accepted bill of exchange, commonly referred to as B/A. It is a negotiable money market instrument, based on an underlying trade transaction. A B/A is created by a bank's customer drawing a bill of exchange on a bank, which the bank accepts, ie, agrees to pay the holder the face value on maturity. Two names, the customer's and the bank's, appear on the bill. The bank charges a fee for its acceptance of the paper and the B/A is discounted at the prevailing market rate.

base metal a commercial metal, such a lead, zinc or copper. The term was coined to distinguish these metals from the superior precious metals of gold and silver.

basis this can have various meanings in futures trading but the most common interpretation is that basis is the difference between the cash market price and the futures market price. Hence 'basis trading' involves taking a view on the price differences between the cash market and the futures market.

basis point one-hundredth of 1 per cent: 100 basis points = 1 per cent; 10 basis points = 0.1 per cent; a bill yield that moves from 10.20 per cent to 10.30 per cent has risen by 10 basis points.

basis swap a swap that is carried out between two floating rates set against two different reference rates. The interest payments exchanged are calculated from two different floating rate indices, usually in $US, such indices being the commercial paper or US prime rate, LIBOR, certificate of deposit rate or US treasury bill.

basket in economic jargon, a mixture. A basket of currencies is a mixture of different currencies, combined to produce a single unit of value which can be used as an index. A basket of commodities goes into the calculation of a consumer price index typically used to measure a country's inflation rate.

basket of currencies see **currency basket**

bear a pessimist, someone who believes prices are heading down (interest rates are heading higher). A bear market is one in which there is a sustained fall in prices and little prospect of an immediate recovery. The historical explanation for 'bear' meaning pessimistic is that bears 'attack by clawing prices down'. The English essayist, Joseph Addison, writing in the 1709 edition of the London *Tatler*, likened short-selling to 'selling the bear's skin before one has caught the bear'—hence the UK term 'uncovered bear' which indicates someone selling short. Bear is the opposite of bull. See **bull**

bear spread an options market technique that aims to take advantage of a fall in price of a commodity or share. A trader would buy and sell options of the same class, for example buy and sell call options on the same commodity or share, with the objective of benefiting from a fall in the price of the underlying commodity or share. A bear (or bull) spread can refer to a futures market position, as well as to an options technique, but is more commonly used with options. See **bull spread, option spread**

Belgian dentist generic term for the European retail buyer of eurobonds. The mythical figure describes the high-income professional such as a dentist, doctor or lawyer who is keen to minimise tax and maximise the return on investments. He or she is an enthusiastic buyer of euro-$A and eurokiwis because of the high interest rates offered and also because the relative weakness of the domestic currencies of the Low Countries (Belgium, Luxembourg and the Netherlands) encourages diversification into assets in a different currency. The buying enthusiasm was tempered at times by a flood of issues and, in the Australian case, by a sharp fall in the value of the currency. The buyers tend to favour known names, such as German banks and prime corporate issuers.

bells and whistles special add-on attractions that dress up an otherwise conventional investment or instrument to give it novelty. Bells and whistles can range from a cheque account with an interest-bearing sweep (retail product) to the more exotic capital market bonds and warrants. They are often used to improve the credit of securitised assets. The new twists are limited only by the imagination of the inventors—typically the Wall Street *wunderkinder*. See **rocket scientist**

bellwether a barometer. Financial markets commentators talk of a particular bond being the 'bellwether' of the market, meaning that the movements in its price are an indication of the mood or health of the market in general.

benchmark rate a rate used as a yardstick for measuring or setting other market interest rates, for example, the US treasury bond rate, the banks' prime lending rate, which banks use to price loans, or the Australian commonwealth bond rate which is widely used as a base from which other securities such as semi-government stock and corporate bonds are priced.

beta factor in futures and share trading, an estimate of the historical volatility (sharp movement) of a commodity's price against a related composite index, for example, movements in the gold price against the precious metals index. If gold were to rise by 6 per cent and the index by 5 per cent then gold's beta factor would be 1.2, being the ratio of 6:5.

bid and ask buy and sell prices. Traders also speak of a bid price, the price offered; the asking price is the price requested. These usually indicate the top price a purchaser will pay and the lowest price a seller will accept.

bid rate an alternative expression, used in share, bond and foreign exchange markets, for buying price.

bill of exchange a form of postdated cheque, a bill of exchange is a negotiable instrument, normally sold at a discount. The person holding it has proof of debt. A bill is an unconditional order in writing, addressed by the drawer to the drawee, requiring the drawee to pay a sum of money on demand, or at a specified future time to the payee (who might be the drawer or another party) or to the bearer. If the drawer accepts the bill, by writing on it and signing it, he becomes the acceptor and therefore primarily liable to pay the bill when it becomes due. If the acceptor fails to pay, the drawer or an endorser must compensate the holder. (Every endorser of a bill of exchange is in the nature of a new drawer and is liable to every succeeding holder should the acceptor and drawer default on payment.)

The formal definition of a bill of exchange under the UK and Australian *Bills of Exchange Act* 1909-1973 is: 'An unconditional order in writing, addresssed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed and determinable future time, a sum certain in money to the order of a specified person, or to bearer.'

The bill of exchange is no modern invention. It dates from the fourth century BC and became popular in the eighteenth and nineteenth centuries as a means of financing expanding world trade. Bills of exchange are widely used in the money market; they are issued by companies borrowing funds and traded through a range of holders until they mature, at which point the holder receives face value from the acceptor. Bills of exchange can be bank-accepted or bank-endorsed, or can rank as commercial bills, in which case no bank name appears on the bill. Parties to a bill of exchange include:

acceptor the party to whom a bill of exchange is addressed and who accepts a bill of exchange drawn on him. Until the bill is signed and accepted, this party is called the drawee. The acceptor agrees to pay the face value of the bill to the person presenting it on the due date. The acceptor of the bill has a direct liability through that bill; he or she is primarily liable to pay out the funds on the due date. But if the acceptor fails to pay, the drawer has to compensate the holder of the bill or any endorser who has paid out.

drawee a bill of exchange is addressed to the drawee, who is required to pay a stipulated sum of money (the face value of the bill) at a specified future date to the payee named on the bill, or to bearer. Once the drawee accepts the bill, by writing on it and accepting it, he or she becomes the acceptor and is primarily liable to pay out when the bill matures.

drawer the party who issues the bill, who makes the order for the bill to be accepted and paid. The drawer signs the bills as its maker and has a contingent liability on the bill until it matures as, in the event of default by the acceptor, the drawer is obliged to pay out the face value of the bill to the holder when the bill falls due.

endorser the party signing on the reverse side of the bill as confirmation of purchase and title to the bill. The list of endorsers' signatures on the back of a bill establishes the chain of ownership of the bill.

payee the person to whom the face value of a bill of exchange is to be paid (as with a cheque). The payee appears as the first endorser on the reverse side of a bill and this endorsement starts the chain of ownership of the bill. The picture becomes complicated when it is remembered that the payee on a bill of exchange can also be the drawer or another party.

bill option in futures, an option over a bill futures contract. In banking, a line of credit which includes the option of using bills of exchange rather than cash, so that the loan can be liquidated by selling the bills. See **exchange-traded options, over-the-counter options**

bill strip a technique that creates a synthetic longer-dated bill of exchange by setting end-to-end a physical bill and a series of futures contracts. This can be done to achieve a higher yield than would be available from either the physical bill or the futures market alone, or it can be used as a means of locking in a term rate for, say, one year.

Black-Scholes option pricing model a device developed in the early 1970s by two US economists, Fischer Black and Myron Scholes, to help assess the value of option contracts. The model was influential in persuading the US Commodity Futures Trading Commission to allow options to be traded again (they had been banned since 1933) as it showed the potential of options for limiting risk. It has become the basic option-pricing formula. With the spread of computers, many companies have developed proprietary formulas of increasing complexity but most are in some way derived from the Black and Scholes model.

board order see **market-if-touched order**

bond a statement of debt, similar to an IOU. A bond is a piece of paper issued by a borrower, such as a government, company or individual who issues the bond in return for cash from lenders and investors. Interest is paid by the borrower to the lender or investor throughout the life of the bond. Details of bond issues to the public are spelled out in each issue's prospectus—these are available from stockbrokers, banks and, in the case of government securities, also from the central bank. A bond has been defined as 'a coupon security offering more than one interest payment' but this was rendered less than totally accurate by the emergence of zero-coupon bonds. Bonds are generally medium-to-long-term fixed-interest securities.

bond market the market where bonds are bought and sold. Most bond trading takes place over the telephone or by using computer screens. Bonds are traded by money market and fixed-interest dealers, by banks and life assurance companies as well as between brokers acting on clients' behalf.

bond tender a form of auction. Governments in a number of countries, including the US, UK and Australia, have raised funds by selling bonds by tender, with the bonds going to the bidders offering the best prices.

book money-market and foreign-exchange dealers talk of their 'book' when referring to total purchases and sales. It is a record of how much they have bought and sold, borrowed and lent. A trader who is 'talking his book' is speaking from a particular position (is biased).

bottomish jargon to describe a market that has fallen to a level that indicates an imminent reversal of a downward trend. Opposite of toppy. See **toppy**

broker someone who buys and sells on behalf of others (the clients). Financial middlemen include sharebrokers, money brokers, fixed-interest and futures brokers and foreign-exchange brokers. By definition brokers do not usually take positions. However, this is not always the case and most exchanges have regulations to ensure that clients are not disadvantaged by the principal activities of a broker or its related companies.

bucket shop an organisation that would solicit orders but not execute them on a recognised futures exchange—an illegal practice now precluded by regulation in most countries.

bull an optimist, someone who is optimistic about the market and interest rates, who sees interest rates falling, the currency strengthening, inflation declining and share prices rising. This person's activities reinforce these trends. A bull market is characterised by sustained and enthusiastic buying. The derivation is thought to be the bull-like action of 'tossing prices into the air with its horns'. A bull is the opposite of a **bear.**

bull spread as with a bear spread, this technique involves the purchase and sale of the same class of options, though it can be used with conventional futures contracts. A bull spread would be the purchase and sale of call or put options on the same commodity,