HongLeong Investment Bank

HL e Futures

WHY TRADE FUTURES?

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WHY TRADE FUTURES?

Futures trading is an alternative trading tool to diversify your investment portfolio. Futures trading offers the following:

LEVERAGING

- Margining system allows you to use smaller capital outlay to invest into a higher value portfolio
- Small movement in the market can translate into a big movement in the portfolio

TWO-WAY ENTRY

- Can initiate long or short positions
- Capitalize on opportunities during an uptrend or downtrend in the market

INVESTMENT DIVERSIFICATION

- Different trading asset classes in futures products for trading e.g. index, agriculture, commodities, energy, metal, interest rate, bonds, etc.

PROTECTION

- A hedging tool to protect the underlying assets or investments while minimizing the losses when the price is on a reverse trend

LOWER TRANSACTION COST

- Commission is charged on a fixed fee per lot basis instead of a percentage of the contract value

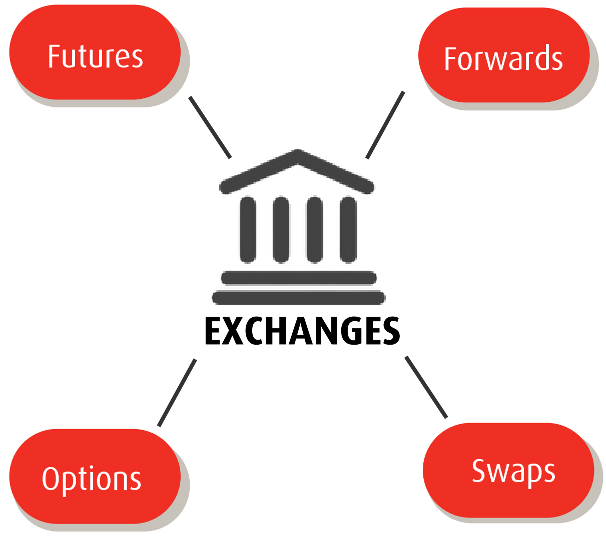
STANDARDIZATION

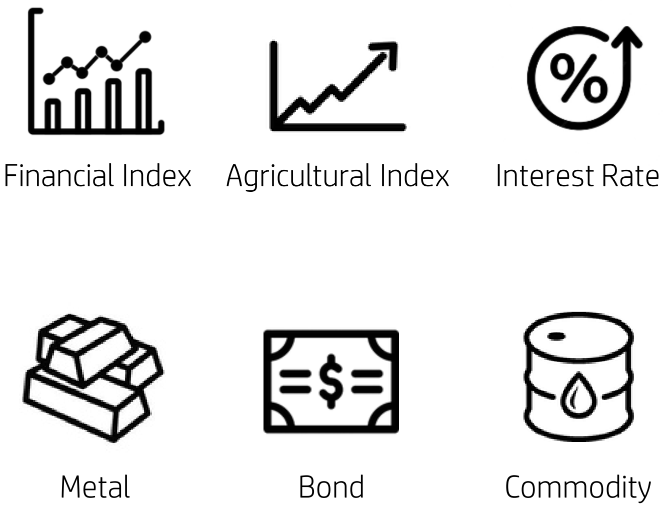
- Contract specification is standardized by the respective Exchanges
- Contract specification is transparent in the market and regulated to avoid dispute

UNDERSTANDING FUTURES MARKET

Futures Market

- Financial instruments whose value depends on some other more basic underlying asset or commodity
  E.g.: Forwards, Futures, Options and Swaps
- Manage and reduce risk and control exposure to adverse price movements associated with holding an underlying asset or commodity
- The futures market in Malaysia is regulated and supervised by Bursa Malaysia Derivatives (BMD) and Securities Commission Malaysia (SC).





What is a Futures Contract?

- A legally binding agreement between two parties to buy or sell a commodity/financial instrument at an agreed price, on a specified date in the future
- The quality and quantity of each contract is standardized by the Exchange, but the price is determined by the market
- Widely used for speculating, hedging and also arbitraging
- E.g.: FCPO is based on underlying asset Crude Palm Oil (CPO); FKLI is based on FTSE KLCI index

Who are the Players?

- Institutional Players - fund managers, insurance companies, financial institutions, commodity trading houses and refineries who manage portfolios and diversify risks
- Hedgers – participants who utilise the futures market to minimize risk exposure in the underlying market
- Local Participants and Retail Investors - individual investors or traders who assume risk in return for the possibility of profits

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UNDERSTANDING FUTURES MARKET

Example of <u>Stock Index Futures</u>

- A derivatives instrument whose value depends on the value of the Underlying Stock Market Index
- The underlying index for the FKLI is the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI), a market capitalization-weighted index of the top 30 blue-chip stocks of Bursa Malaysia.

Example of <u>Commodity Futures</u>

- A derivatives instrument whose value depends on the value of the Underlying commodity
- E.g.: Crude Palm Oil Futures (FCPO) is derived from the underlying physical Crude Palm Oil prices where a contract is made between a buyer and seller to take and make delivery at a future date
- Prices are determined by market supply and demand

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TYPES OF ORDERS

Types of orders are the conditions that are provided by the respective Exchanges. Traders can create orders that meet their trading requirements and define the price level with conditions to be fulfilled.

Market Order

These are orders placed for immediate execution at the best available ask or bid price in the market. Generally, market orders are used when the trader wants a trade-done quickly and is not too concerned with negotiating for a better price.

Limit Order

A limit order stipulates a price limit for the execution of the transaction. A buy limit order indicates that the futures contract may be purchased only at the price designated or at a lower price. A sell limit order indicates that the futures contract may be sold at the price designated or at a higher price.

Stop Order

Whenever the futures trades at or beyond the designated price of a stop order, the stop order converts into a market order. A buy-stop order specifies that the order is not to be executed until the market rises to a designated price. A sell-stop order specifies that the order is not to be executed until the market price falls to a designated price.

Stop Limit Order

It is a buy or sell order that is to be executed at a specified price or better, once the price of the instrument in the market has reached the trigger price that has been specified. Stop limit is best used when a trader wants to enter or exit the market at certain specified prices known as Trigger and Limit prices.

Basis Orders

Also known as spread orders, basis orders are used for taking a spread position, i.e. the simultaneous purchase and sale of contracts with different expiration date. The trader attempts to make a profit from changes in the differential between the market price of the respective contract month as time goes by.

One Cancels Other/Order Cancels Order

A two-leg order (stop vs limit) where the profit target is set with a limit order, while a stop order provides protection from losses.

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ORDER VALIDITY

By default, each working order is only valid until the end of the trading day that the order was executed. If the trader wishes to continue to carry the working order to the next trading day, set out below are the options available:

Good-Till-Cancel (GTC)

The order remains valid until either fulfilled or cancelled, or until the contract month expires. It is prudent that a record of such orders is kept and monitored on a daily basis.

Good-To-Date (GTD)

The order remains valid until the end of a specified trading date.

Day Order or Good for the Day

The limit or stop order will lapse at the end of the trading day if no particular date has been set for its validity.

INITIAL MARGIN DEPOSIT

An amount known as initial margin is required to be deposited with the broker to initiate a trading position.

Futures contracts provide leverage through margin where an investor needs only put up a marginal sum of the contract value instead of the full amount of the contract value.

This sum of money is often referred to as the Initial Margin. It ensures that counter-parties to the transaction can pay the cash difference when the trade is settled.

Margins are required to be deposited with the broker to start trading.

GLOSSARY

Common words used in Futures trading:

Ask Price	Also called the "offer." Indicates a willingness to sell a futures contract at a given price.
Bid Price	An offer to buy a specific quantity of a commodity at a stated price or the price that the market participants are willing to pay.
Bear Market	A market in which prices are declining.
Bull Market	A market in which prices are rising.
Contango Market	A market situation in which prices are higher in the succeeding delivery months than in the nearest delivery month. Opposite of backwardation.
Final Settlement	Final disposition of open positions on the last trading day of a contract month. Occurs in markets where there is no actual delivery.
Hedge	The purchase or sale of a futures contract as a temporary substitute for a cash market transaction to be made at a later date. Usually involves simultaneous, opposite positions in the cash market and futures market.
Arbitrage	The simultaneous purchase of cash, futures, or options in one market against the sale of cash, futures or options in a different market in order to profit from a price disparity.
Initial Margin	The minimum deposit required for each contract that the client needs to place with the broker. The amount of the initial margin is set by the Exchange. The broker will send a Margin Call notice if the client's equity falls below the initial margin requirement.
Mark-to-Market	Settlement process for open positions based on the close of that day's trading session.
Open Interest	The total number of futures contracts long or short in a delivery month that has been entered into and not yet offset or fulfilled by delivery. Each open transaction has a buyer and a seller, but for calculation of open interest, only one side of the contract is counted.
Short Position	When a trader sells a futures contract first with the intention of repurchasing or covering the position later at a lower price. A trader may decide to short a security when he believes that the price of the futures contract is likely to decrease in the future.
Spread Trading	Simultaneously sell and buy futures in different contract months under the same futures contract. Example. Bear spread is sell the near month contract and buy the far month contract.
Last Trading Day	The last trading day for the futures contract in the particular month.
First Notice Day	The first day on which a notice of intent to deliver a commodity in fulfillment of a futures contract can be made by the clearing house to a buyer. The clearing house also informs the sellers who they have been matched up with.

This glossary of common words used in Futures trading is compiled by HLIB from a number of sources and HLIB does not warrant or guarantee the accuracy or completeness of the definition. The purpose of this compilation is to promote a better understanding of the futures markets.

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CASE STUDY

This is a case study on FKLI product margin requirement and profit & loss calculation. Assumptions made on the current margin requirements for FKLI futures contract are:

- Initial Margin (Outright Position) = RM 4,500
- Every 1 point of movement is equal to RM 50.
- Brokerage is not calculated for simplicity in calculation
- Investor is bullish on the index market and would like to long/buy the FKLI contract. The investor has to deposit RM 4,500 for initial margin requirement

Trading Day One (T Day)

- Investor A initiated a long position for FKLI spot month at the price of RM 1600.
- Assuming that end of the day the settlement price is at 1600.
- Thus, he is not making any profit and loss and equity remains at RM 4, 500.

Trading Day Two (T+1 Day)

- Index futures contract fell 15 points to 1585 at the close.
- Investor A's margin account will be debited by a variation margin of RM750, leaving his equity balance at RM 3,750.
- There is a margin call of RM 750, as the initial margin required is RM 4,500.
- Thus he has to bank-in RM 750 to top up the margin on next day.

Trading Day Three (T+2 Day)

- After top up of RM 750, Investor A equity balance is at RM 4,500.
- Market turned bullish on T+2 day Investor A took profit by selling at the price of RM1610.
- After closing out the position, Investor margin account made a profit of RM1,250 and the net equity balance now is RM 5,750

This table below illustrates the day-to-day account balance for Investor.

Trading Day	Futures Index Price	Profit/Loss (RM)	Equity Balance (RM)
1	1600.0	-	4,500
2	1585.0	- 750 (15 pts x RM 50)	3,750
3	1610.0	+ 1250 (25 pts x RM 50)	5,750 (RM 3,750 + Top up RM 750 + profit RM 1,250)

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EDUCATION MATERIALS

Click the items below to access the resource links.

CME Group

- Introduction to Futures
- Understanding the Benefits of Futures
- Introduction to Agriculture
- Introduction to Crude Oil
- Introduction to Energy
- Introduction to Grains and Oilseeds
- Building a Trade Plan
- Trading and Analysis
- Trade and Risk Management
- Technical Analysis
- Tick Movements: Understanding How They Work
- Mark-to-Market

BURSA MALAYSIA

Daily Market Commentaries provided by Bursa Malaysia Derivatives Exchanges

SGX SINGAPORE EXCHANGE

- Introduction to Futures Trading
- Trading the SimSCI Futures & Single Stock Futures
- Swing Trading Methods

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You will enjoy the following benefits when you trade with HLeFutures.

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Competitive brokerage fee

Experienced dealers at your service

Trading facilities for both local and foreign futures contracts

DISCLAIMER

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