

Futures Industry Is Seen Standing On Doorstep of Expansionary Era

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In the span of only 20 years, less than a blink from a historical perspective, futures markets experienced a metamorphosis of such dramatic proportions that in retrospect it defies comprehension. I dare say our recent revolutionary experience represents a phenomenon having no equal on the business front and is comparable only to current advances in science and technology. . . . And most of what happened to us transpired in but the last decade.

• Our markets, which since time immemorial were the unique and exclusive domain of agriculture, overnight became an integral mechanism of finance.

• Our markets, which for more than 100 years were strictly limited to tangible and storable products, suddenly shed this seemingly inexorable covenant and embraced live animals, foreign exchange and government securities.

• Our markets, the defined boundaries of which excluded entry to the arena reserved for securities, brazenly transgressed the dividing line by inventing instruments which blurred the age old distinction.

• Our markets, the congenital structure of which demanded a system of physical delivery, broke their genetic code and thrived without delivery.

• Our markets, the universe of which was so insignificant that in 1962 they could only generate 5 million transactions, traded 112 million in 1982, a 2,200 percent increase.

• Our markets, which only yesterday were viewed with scorn and barely on the edge of respectability, are today an indispensable and welcomed member of the financial family.

• Our markets, the commercial values of which a few years ago were reluctantly subscribed by the users of a handful of U.S. states, are now



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arenas of international scope and the envy of the rest of the world.

Can we in all honesty expect that our markets will, in the next 20 years, equal or even approach the futures revolution I have just described? . . . I seriously submit that anyone who believes this is an unrealistic dreamer. I for one do not.

Nor should we want a similar experience in the immediate years ahead. Indeed, were it to be attempted I daresay it would fail and threaten the conquests of the past. We dare not make Napoleon's mistake by advancing on too many fronts and beyond the reach of our supply lines.

Rather, the time ahead should be — and I expect it to be — an era of enhancement, entrenchment, and maturation. The conceptual breakthroughs and inventions of the futures revolution desperately demand — and I submit, will receive — time to explore their new territories, time to fortify their new bases and time for their new identities to mature.

But before anyone here accuses me of preaching heretical dogma or

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worse, allow me to elucidate. I am not for a moment suggesting our industry is about to stop growing or that we will not henceforth witness new contracts or even conceptual innovations.

Quite to the contrary. As should become abundantly clear in short order, I believe our futures markets are about to enter an explosive expansionary phase. However, if the futures revolution of the past two decades can be defined as representing a horizontal advancement, then the next two will be of a vertical dimension.

I submit that our industry will — during the foreseeable years ahead — fully capitalize on the conquests of the 50s and 70s. The new horizons we have unveiled, the new directions we have assumed, the new inventions we have spawned, deserve and will receive our full attention. Indeed it would be an unconscionable disservice to the labors of the past if we did not now spend the time to exploit their full value.

Clearly, cash delivery has single-handedly unshackled futures from its most trying constraint, one which once represented an insurmountable wall around our existence. Its demolition has extended the mechanics of futures to realms never before imagined.

The new era which has thus dawned is of a wider dimension and of greater promise than even its precursor, the financial era, which made it all possible. Cash settlement in lieu of physical delivery enables us to contemplate and explore market applicability in virtually every facet of human endeavor.

Concepts and intangibles have now become subject to futures trade and this potential will no doubt challenge the minds of even the most provocative market innovators. It is imperative we take the time to carefully investigate all the avenues of this new domain.

In passing, allow me to state for the record that the new era upon us would most likely never have transpired without the existence and courage of the Commodity Futures Trading Commission. The concept of cash delivery — so simple and universally accepted a methodology for settlement of contractual obligations, one that is commonplace in every other field of business or walk of life — was obstinately and irrationally barred to us and I daresay would have remained so were it not for the CFTC.

Because, historically, futures markets have been so little understood, their necessity suspect, their mechanics different and confusing, they were viewed as something perhaps to be tolerated and humored, but not to be advanced.

It was only by virtue of the faith placed in the wisdom of a congressionally ordained entity, that the issue of cash delivery had a chance to be resolved in our favor. It is to the CFTC's everlasting credit that this was accomplished and unquestionably will be recorded as one of its paramount achievements.

Clearly the first wave of index futures is but a sample of what lies ahead. The world thrives on indexes. They have become ubiquitous tools of management in every form of enterprise; they run the gamut from the private to the public sector, from finance to agriculture, from the very specific to the general.

As everyone knows, work is already proceeding or being discussed on index contracts pertaining to corporate and municipal bonds, insurance and freight rates, producer and consumer prices, agriculture and housing starts, retail new car sales and a host of others too numerous to mention. Moreover, some contract markets have even announced creation of an index contract on a specific or representative group of futures contracts.

In some cases the index involved is already in existence and compatible with the mechanics of futures; in others refinement is needed; still in others the index must yet be created. However, they are chosen or constructed, there is little doubt that in the coming years all will be tested.

Tangentially, options on those same indexes will also be attempted. Obviously not all indexes will take to options, but there is evidence to suggest that some will do better than the traditional futures vehicle while in other cases, like with the stock index, the instrument will function best in parallel fashion.

But the specter of options on futures exchanges goes far beyond the index markets. The very nature of the option mechanism is so different from the traditional futures contract, it spells yet another new dimension for our market potential.

In similar fashion to indexes, options will run the gamut from agriculture to finance and from the specific to the general. By definition, options will offer market applications never before possible, and will thus

bring to our world, participants who never envisioned using a futures' broker.

Nor will all our new markets be limited to index and options. Axiomatically, our industry thrives on change and responds quickly to new opportunities. One cannot foretell what they will be, but surely they will happen.

Just as energy futures emerged as a result of a sudden crisis in the world oil supplies, just as currency futures were spawned by the breakdown of the Bretton Woods Agreement, in the same manner and for similar reasons, as the need becomes apparent, our markets will have the foresight and competitive motivation to respond. And each new invention will spur yet another idea.

Surely not all new contracts will succeed. There are bound to be failures along the way as there have been in the past, but that is the price of success and competition. Indeed, I have little patience for those who fret about proliferation.

The marketplace itself is the only and best determinant of which ideas are viable and which are not. I daresay, those products which are flawed will fail quickly enough; those which are redundant will find it most difficult to compete; those which do not answer a specific need will find few users. But let the market make this determination rather than some regulator or an industry committee. The dynamics of our industry are such that it must continue to explore, experiment and invent in order to respond to a current or prospective need — real or imagined.

Thus the coming years in futures will as in the past continue to produce new contracts of trade, but rather than being the result of still another revolutionary breakthrough, they will represent extensions of the advances we recently inherited. Similarly, the new era will also harvest the fruit of past labors in two other highly sufficient areas: volume and stature.

Leo Melamed has served as special counsel to the board of the Chicago Mercantile Exchange (CME) since 1977. Previous to this office, he was chairman of the exchange from 1969 to 1972. In 1972, he became chairman of the newly established International Monetary Market (IMM) division and remained its chairman until 1976 when it was merged with the CME. In that year, he again became chairman of the parent institution until his appointment as special counsel.