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THE WILD WORLD OF COMMODITIES

Futures Trading's Not A Crap Game, According To Leading Participants

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CHICAGO — To the uninitiated, one look at the yelling, hand-waving traders on the floor of the Chicago Mercantile Exchange is enough to prompt some such response as: "They're crazy! How can business transactions be handled in such a manner?"

Yet it is done, and with a remarkable degree of efficiency.

The whole area of commodity futures trading is one that not only has experienced phenomenal growth over the years but which is gaining the interest of more and more speculators as time goes on and as new commodities are added.

IN THE PACIFIC Northwest, few people, until fairly recently, were aware of what futures trading is all about. Now, however, with trading being carried out in both lumber and plywood futures contracts, there is interest on several levels. Producers are looking into and learning about the intricacies of futures trading to protect their inventories against violent variations in cash market prices. Wholesalers, too, are looking to the futures markets as hedging mediums. Also, to an increasing extent, builders are taking an interest to see how they can protect materials prices. A few speculators are also entering the picture locally.

The average person hereabouts, who has not made an effort to educate himself in this field, nevertheless has, most likely, some ingrained misconceptions about futures trading. Correctly assuming that some financial writers might also harbor such misconceptions, the Chicago Mercantile Exchange this week held a seminar here to explain how futures markets work and to clear up whatever mysteries and myths might lurk in the minds of the writers and, ultimately, their readers.

MANY PERSONS, it was noted, seem to think the commodities exchanges are not as well regulated as the securities exchanges. Not so, said William M. Phelan, vice president of audits and investigations for the CME. Phelan explained that an arm of the U.S. Department of Agriculture, the Commodity Exchange Authority, does indeed do in the commodities market what the Securities and Exchange Commission does in the securities field. Furthermore, he pointed out, the CME and the Chicago Board of Trade exceed the requirements of the CEA, doing their own policing and checking.

And then there's the oft-spoken myth that speculators in commodity futures are really no more than sophisticated gamblers engaged in a sophisticated, legalized crap game. Dr. Charles V. Harlow, associate professor of finance at California State College and an acknowledged expert and author in his field, disagrees. "Gambling involves the creation of a risk for the sole purpose of someone taking it . . . Gamblers are willing to accept these risks in return for the opportunity to win some money," he explained. "Speculation on the contrary deals in risks that are necessarily present in the process of marketing goods."

OPEN OUTCRY is what they call it . . . and it is. It occurs in "pits" of Chicago Mercantile Exchange where brokers execute customers' orders by attempting to find buyer or seller.

WILLIAM PHELAN
. . . Well regulated

CHARLES HARLOW
. . . Too many myths

LEO MELAMED
. . . Gamblers lose

HARLOW WENT on to show that, without speculators, futures markets could not exist. "Speculators attempt to anticipate what prices are going to do in the future," and, if they're right, they make a profit and if they're wrong, they lose. In the process, however, they inject their risk capital into the futures market and thereby make the market efficient and useful to producers and users who use the same market for hedging purposes.

There is also a factor of "social utility" involved, Harlow noted. The stock trader, he said, deals in a "secondary market" in which his investments in corporate shares create little or no social utility. The futures contract purchases made by a speculator in commodities — a "primary market" — might well create social utility by reducing prices to the consumer as the speculator assumes the risk which otherwise would have to be borne by the producer.

Harlow also touched upon one of the most common misconceptions in commodity futures trading — the matter of delivery. Many believe that owning, say, a carload of lumber for May delivery, will mean that the holder of the contract will have to accept delivery of that lumber. As a matter of fact, Harlow explained, less than 3 per cent of futures contracts traded ever result in delivery. Most such contracts are liquidated by selling and even those that run on into the option month are usually disposed of before the delivery date either by selling the contract to someone else, or by simply selling the product on the cash market.

SUMMARIZING, Harlow concluded, "Commodity trading is legitimate speculation; price movements are not excessively volatile; hedging is not an automatic risk-free money maker; there are speculators who win consistently in the commodity markets; and trading in commodities is, if anything, easier than trading in securities."

Leo Melamed, a professional trader and currently chairman of the board of the CME, called commodity trading "one of the last significant fields remaining where someone can still pyramid a sizable fortune from a modest investment." To Melamed, it's all a case of mind over matter — a self-imposed discipline which requires a well-adjusted personality without major hangups. Luck, he said, has little or no part in the process. It's mainly a matter of carefully analyzing the facts, coming to a conclusion as to where the price of a given commodity will be several months from now — and then hanging on.

"Luck is a minimal ingredient," said Melamed. "The laws of chance are relatively inapplicable and, if anything, a detriment to futures trading." The gambler's attitude, he explained, is more or less disrespectful toward money and "does not lend itself towards the rigid and disciplined rules required in good commodity trading . . . When gamblers try their skill at commodities, they invariably