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Fifteen Years Later

Leo Melamed is synonymous with financial futures. He transformed the Chicago Mercantile Exchange from a struggling agricultural market into a powerhouse of the financial world. In the process, he helped give birth to an industry.

Will the next 15 years be as spectacular as the first 15? Perhaps, Melamed says, although the growth will be of a different kind. Instead of expanding the use of futures by jumping into new market areas, the industry will grow through internationalization and product specialization.

The globalization of the markets, Melamed says, will create an "intertwining effect" that will improve the efficiency of the markets and attract new users. Eventually, there will be three centers of futures trading, all of which will be linked together: London, Chicago, and either Tokyo, Hong Kong, or Singapore. Twenty-four-hour trading will become a reality as high volume products such as government bonds, equity indices, and currencies will be traded in all three markets.

Domestically, Melamed foresees a "piggybacking" of different kinds of instruments in similar product areas. Futures, options, and options on futures will be traded on the same underlying products. The proliferation of instruments will provide arbitrage opportunities for traders and a wider variety of options for hedgers.

Clearly, one of the biggest growth areas will be in equity products. In the U.S., Melamed predicts derivative products will be developed on industry indices, such as a transportation index or a financial index. Also, foreign stock indices will begin trading in the U.S., probably on the Japanese Nikkei index and on the European, Far Eastern, and Australian indices.

Foreign bonds represent another area of potential growth for the U.S. market. Although no one has come up with the precise trading instrument thus far, Melamed believes that the success of Japanese yen bonds in Tokyo could be translated to the U.S. market.

"We've gone through a long period of horizontal growth where we've grown by going into new areas," Melamed says. "Now, we're in a period of vertical growth where we're adding options and creating global links."

Melamed believes that the recent spate of negative publicity on equity futures and the S&P 500 pit will not discourage institutional use of stock index futures. The futures industry, he notes, always has had an image problem with the general public. That image problem, however, has no effect on institutions, he maintains.

"I don't think there's anything to be ashamed of. If you measure the futures industry against other industries—real estate, securities, banking—I don't think we come in last place, or anywhere near last place, in terms of quality of membership, quality of execution, or quality of performance," Melamed argues.

Although the CME has restricted dual trading (the trading of both customer and personal accounts by a floor trader) in the S&P 500 pit, Melamed claims that the new CME rules are not applicable to other markets. Dual trading, he says, has served the industry well, though he acknowledges that it can lead to conflicts of interest.

Similarly, Melamed maintains that portfolio insurance and cash-futures stock index arbitrage are not causing gyrations in the stock market, as some critics allege.

"Portfolio insurance cannot be looked at in a vacuum," Melamed says. "It's part of a mechanism of an action that's going to be performed by a manager. If he does it in the cash market rather than the futures, I think it will be a lot worse on the individual stocks involved, because they will be hit much harder than the futures market."

Markets do react much faster than in the past, Melamed allows, but that's a function of computerization and better communication, not new trading strategies.