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The Way It Was
An oral history

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"I said to the traders of the Merc, 'Look, you've got to leave your cattle pit, your hog pit, your belly pit'"

No one has been more instrumental in fostering the growth of financial futures than Leo Melamed. Melamed created the first currency futures contract fifteen years ago when he headed the Chicago Merc — and helped revolutionize global finance.

Innovation happened at the Merc because we were hungrier, because we had much more to gain with success than an institution that was already very successful, such as the Chicago Board of Trade. The Merc was on the make. And so when you have that kind of institution and you have a brand-new idea and you have a membership that is willing to follow you and you yourself are capable of being a leader, you've got a mix of dynamite and innovation. And so, in 1967, I was swept onto the board of the Merc on the need for reform.

The first thing I did was to ask that the rule that discriminated against women being employees or members of the exchange be dropped. And there was a big

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argument on the board because the question was, How much above the knee should the skirt be allowed on the floor? — in case it would give the members problems, you know, distractions in this very, very businesslike atmosphere we have on the floor. God forbid. You know, with the tumult, nobody cares if you are a woman, a man or a guy from Mars.

At the time, I suspect a lot of the older members thought this young turk was going to bring down the Merc with all these horrible innovations or experiments. Anyway, the first stage of the innovations was this organizational effort to redo the rulebook, change the rules, modernize them and stop the corners and the squeezes. The membership felt they had very little say in the process of governing the exchange and that the exchange had done some very dumb things that the members felt hurt their future, such as the onion debacle of the previous decade, when corners and squeezes allowed that market to go down the tubes.

We traders lost a lot of money over the course of time, and clearly all us felt victimized; we felt that the institution was being raped before our eyes. It gave the Merc a bad name. Unless you're on the inside, you don't know what is going to happen tomorrow, because the market seems to go contrary to the dictates of supply and demand. It goes up when you know everything dictates that it should go down. It's hard enough to be right just on the basis of supply and demand in futures. And if you add to that the element of corners and squeezes, the public wouldn't have a chance. Anyhow, I represented a lot of people who felt the governors of the exchange were too lax and seemed to turn their heads away instead of confronting the issue. This is not to say they were in on the manipulation. I don't know. I never knew and never really cared. I gave teeth to the business conduct committee so that it could deal with corners and squeezes, and that was the first step of what I did for the exchange.

The second step was diversification, and that was in 1971. The rulebook was now in place; we were successfully doing the meat business; we were growing. But I had learned during my formative years on the exchange that if an exchange becomes overdependent on one line of business, like it had been on eggs, and if anything happens to that line of business, then you are out of business. And let me tell you that in terms of agriculture, we had hit the limits. I mean, the CBOT had grain and all the grain by-products, so we were locked out of that. We already had meats and we were doing well, but, I mean, where could you go with that? You can't invent another meat.

So now we were all meat, and I said we must diversify. You cannot depend on meats. In my mind was another idea, entirely different: not agriculture, but currencies. I saw finance as a universe that was totally untouched, completely open and the sky was the limit. I recognized this would be revolutionary, but it was there. I had my ear to the ground. I had attempted trading through the banks. I recognized that while Bretton Woods was in existence, currency fluctuations, at least in the open, weren't likely — except on nights when finance ministers got together and devalued 2 percent or 5 percent or 10 percent and suddenly you have this giant move overnight and the rest of the time it's fixed.

I and some friends used to talk about these things. We focused on the fact that the British pound was overvalued. It was well out of line, and either the British government would go broke trying to hold it (which they almost did) or they were going to have to let it go or devalue. So the key to making money was to find some way to be short sterling. And, of course, there was no way, because the banks would literally not take your money. So if Bretton Woods would indeed come apart, then my idea for a currency futures market could work. This fit diversification, and it fit the world that I thought was coming.

I was interested in economics, and Milton Friedman's name and writings attracted me like a magnet. I even visited his classes at times. I became more enamored of his ideals and his ideas about free markets. They fit exactly. Here was a man saying exactly what I was thinking. Only he had the credentials to say it, which made me feel real, real good. If Milton Friedman's view that Bretton Woods would indeed come apart in the near future was anywhere near correct, then my ideas for a currency futures market could work.

So the president of the exchange, Everett Harris, and I met with Friedman and asked him what he thought of the idea. Well, he loved it. He embraced it instantly. So we asked him, "Would you give us the benefit of a feasibility study?"

In December of 1971, when the gold window was closed, I knew we were on the right track. And we were all ready. All we had to do was do things quickly now, and we did. We set the date for May 1972. I said to the board: "You don't launch currencies from your back pocket and say to the world that we are doing something in Chicago that isn't important. If it is meaningful, then we ought to advise the movers and shakers of the world." I wanted people to salute it.

In those years, from 1972 to 1976, I crisscrossed the country so many times I can't count them. In seminars, speeches, one-on-ones, all over the country trying to preach the idea of currency futures and that the idea was the right idea at the right time and that it was going to work and that one more thing: the Chicago Mercantile Exchange was an okay place to do business. And the International Monetary Market, the IMM, was created as a separate organization that sold its own memberships to the world. I said to the traders of the Merc, "Look, you've got to leave your cattle pit, your hog pit, your belly pit; you've got to come help us launch currencies." And they came and did it. But I also knew they had to make a living. These people would give me their time, but for how long? I knew I needed a captive constituency of traders that would concentrate solely and only on the currency markets.

There was a tremendous amount of money to be made. When we launched the IMM, it was when the Swiss franc was selling, I recall, for 28 cents to the dollar. It went from that over time 'til 1979, when it was something like 79 cents. So there was big money to be made. Also, there was somethin[g] else. You couldn't squeeze and corner th[e] currencies. Nobody was worried about some people getting together and saying, "Hey, let's corner the deutsche mark tomorrow." You knew it was economics that was going to dictate that market. Supply and demand was going to determine the value, nothing else. Oh, sure, government intervention was popular, but we viewed government intervention as just another big player. They were entitled to their view, and they could deflect the market for a while. But we knew the market was bigger than they were.

Morrie Levy was one of the great protagonists of the currency futures. He and his brothers were spreaders in the meats. Spreading, as you know, is just a technique, arbitrage, that you can do anywhere. Right. They recognized that very quickly. He knew there was a connection between the deutsche mark and the Swiss franc and maybe even with the others. So, therefore, he could spread one against the other, and he learned how to do that.

With very little training, you can translate and transfer your knowledge as a trader in one commodity to another. There are stories of people who have never seen a pork belly, and they have been trading it for years. There is an old saw that goes, "A real good trader walks on the floor and listens to where the noise is com-

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"Where else can you lose the kind of money you can with futures?"

ing from, and that's where he goes to trade." It doesn't matter what it is, because markets go up and down on the basis of supply and demand. And if you are a pit trader, all you want to do anyhow is go with the flow.

Pit trading is a seat-of-the-pants game. It's go with the flow, and the years haven't changed it. If you are an upstairs trader, like I am now, you trade from the screens, and I trade differently than I did in the pit. But now the market has moved dramatically. The volatility factors have changed. Why? Because the computer has married the telephone, and now everybody has instant access and instant information, and these changes create more and more volatility. You need more capital to stay in business, but by the standards of world capital, it still isn't that much.

At the Merc, we never were looking for vindication, but we sure were looking for business. But if I had to pick a date when we *were* vindicated, I would pick September 1, 1976. That was the day the Mexican peso was devalued 50 percent and the entire world was all shook up. Nowhere could you get a forward price in Mexican pesos — except where? At the Chicago Mercantile Exchange, our market was right there. It opened up. It never had to sweat. A hundred million dollars changed hands, and we were safe and secure. And the world took notice that the Chicago IMM stayed in business and continued to trade Mexican pesos. I think from that day forward, it really started to move fast. Our market represented a viable force in currency forwards, so we often led the direction of market change. And that is still true today.

Sure, we made mistakes. The mistake we made the first day was trying to launch — imagine — seven currency contracts at one time. We'd never do that today. Today it would probably take an entire year. You don't launch seven in one day. But at the time we organized the contracts, we did not know enough not to listen to the bankers. So we created contracts that were far too large, and we couldn't get the public to participate when they had to put up this large amount of money.

Also, I would clearly have preferred to have the long bonds at the Merc. I would have done that differently, but I was talked into doing a four-year note. Our economists made the case that the world was going to the middle range of the interest rate spectrum rather than the long range. So we went with the four-year note in 1977 when we should have gone with the long bond — obviously, a big mistake. But economists sometimes make that mistake. Interest rates was the next stage, and then came probably the most important new product of recent vintage — no question about it which is — equity futures.

Stock market futures were not a new idea. I remember as a kid on the floor being cornered by Elmer Faulkner, a little guy who wore spats — that was the thing I remembered about him. He smoked a big cigar and he used to spit in a spitoon that was on the floor. He said to me, "Of course, the ultimate future is the stock market futures." And then he'd spit into a spitoon and say, "But you'll never see it in your lifetime." Well, we wouldn't have if we couldn't have convinced the CFTC that cash settlement was something they ought to experiment with. And it took us four years to convince them — from 1978 to 1982.

The first cash-settled contract was Eurodollar futures, launched in 1982. And once they approved the idea of cash settlement, we all went scurrying about for the stock market of our dreams. All our analysis indicated that the portfolio manager, who we felt was going to be the one that will eventually drive the business toward us, measured his performance on the basis of the S&P 500. We went after that contract because the S&P 500 is the way the world measures performance in stocks.

But we had to launch six months after the other exchanges. We had to put on a hell of a marketing effort to succeed. We immediately overtook the others after the launch of the S&P 500 futures. But then, three, four weeks later, we were behind them. Jack Sandler [chairman of the CME] and I were in London. We got on a plane and relaunched the S&P 500 with a pretty famous marketing plan called 15 Minutes, Please. We urged every member of the exchange to stay 15 Minutes, Please, in the S&P pit. We turned it around in a couple of weeks, and we were off and running.

We have always gotten more response out of our membership at the Merc than any other exchange. But I caution you: I don't know that this is the way the world can always work, because you get beyond a certain number of people and it probably doesn't work as well.

Futures has always had a sordid history. Not just at the Merc; it was true at all the exchanges. It's misunderstood; it's little understood. It looks like a gambling casino, and therefore it is used as a scapegoat. When anything goes wrong in the world, it is easy to pick on futures and say it is their fault. We have proved time and time again that it isn't our fault. They have had soybean examinations. They blamed their recent problems on program trading and then, when it is examined, you find out program trading had very little impact on the recent volatility in the stock market.

But we represent an odd and difficult world. Where else can you, in the same day, lose the kind of money you can with futures? It sounds like it's Vegas; it's colorful and noisy and all that, so that's odd for a business arena. It's not a bank-looking place. I grant you, the New York Stock Exchange doesn't look all that different, but the New York Stock Exchange has this long history of respectability. After all, it's the pillar of our financial world, and it is where capital formation occurs. So what can be wrong with that?

But I think we've established our legitimacy now, partly because of who we are; we are no longer the pork belly and cattle traders only. Look who is among our ranks: Salomon Brothers, Goldman Sachs, Morgan Guaranty. We recognize that their entrance into our world will give us the legitimacy we've always thought we deserve, and why should it bother us that maybe they came a little late?

Now we are in a transition stage, and transition stages are very hard. We have brought in a whole new clientele, a whole array of new markets, and they demand different technologies. Their way of doing business is different. I think we have to experiment with the technology without endangering the open-outcry system, because I don't think technology can create liquidity the way a competitive arena does it, eyeball to eyeball — a bunch of people, each competing for a price. It just doesn't happen the same way in the sterile atmosphere of your office.

Our way works. It's an open fishbowl. A lot of business does happen here, and there is an honor system among the traders. There are some bad apples in every barrel and we've got our share, I am sure. But overall, the community is an honest one.

The reason our traders carry business cards that say "capitalist" is that they are conscious of what they represent, and they are proud of what they represent. They've been to New York; they've been to Singapore. They've been all around the world, and they know what they've got in Chicago isn't anywhere else. These markets do represent a last frontier in a way.

People have tried to mimic what we have here, and sure, there is a little bit of Chicago in Singapore, a little bit of Chicago in London. But in Chicago, you've got the real thing. ■

Editor: Henny Sender