THE WALL STREET JOURNAL.

★ Midwest Edition MONDAY, FEBRUARY 22, 1982

Futures Frenzy

Chicago's Traders Take Big Lead in Devising Ways to Build Markets

They Overshadow New York Despite Bitter Squabbles Over Running Exchanges

By HARLAN S. BYRNE
Staff Reporter of THE WALL STREET JOURNAL

CHICAGO—Leo Melamed grimaces as he recalls how he was laughed out of the office of a New York banker 10 years ago. Mr. Melamed was explaining a novel plan for the Chicago Mercantile Exchange to start a futures-trading market in foreign currencies.

"He asked me if I had escaped from a mental institution," says Mr. Melamed, a former chairman of the Chicago exchange.

As a veteran commodities trader, Mr. Melamed was used to outsiders having a weird conception of his business — their views colored no doubt by its pandemonium of screaming and hand-signaling of prices on exchange trading floors and by the industry's far-from-spotless reputation. So Mr. Melamed left the banker's office feeling put down but still resolute.

Since then he has enjoyed a whole series of last laughs. Not only did the currency market succeed, but it has been the forerunner of a trading explosion in financial futures that has spread to other exchanges and a broad variety of other instruments such as U.S. Treasury bills and bonds, bank certificates of deposit, government-insured mortgages and even Eurodollars.

A Major Coup

Mr. Melamed's experience says a lot about Chicago's fast-growing futures exchanges and the way their traders have been showing Wall Street a thing or two. The Chicago Board of Trade, the biggest of all the futures exchanges, and the "Merc," a healthy No. 2, have led the way in expanding financial futures since the mercantile exchange got the ball rolling with currency futures. The Board of Trade's big coup was in launching the exchange trading of stock options. The Chicago Board Options Exchange, or CBOE, formed nine years ago, was an immediate success and, in turn, prompted the American, Philadelphia and Pacific stock exchanges to follow suit.

The aggressive ways of the Chicago traders carry over to internal affairs of the exchanges where bickering has escalated recently. Both the Board of Trade and the Merc are in the midst of controversial organizational changes as they gear up for new markets and a flock of new traders. Such major changes aren't coming easily because of the objections of veteran traders who fear a jump in the trading population could dilute the value of their memberships.

So far, nonetheless, diversification of the Chicago exchanges has been a boon. Board of Trade and Merc trading volume has zoomed more than eightfold in the past decade, while CBOE trading has risen more than 600% in its nine-year history.

A Further Explosion

Some traders believe that a few years from now financial futures will overtake conventional commodity futures, such as corn, soybeans and wheat, in total volume. Already, financial futures account for about 30% of all futures-trading volume, compared with practically nothing a decade ago. And in 1981, the Board of Trade's Treasury bond contract moved to the top of the list of all futures-trading contracts in volume, dropping corn and soybeans to Nos. 2 and 3. At the Merc, whose share of industry volume has climbed to 25% from only 8% two decades ago, financial futures accounted for 60% of the exchange's volume last year.

Today, both of the big exchanges believe that they are on the verge of a further explosion in trading activity—at least a doubling of present volume by 1985—and have committed more than $300 million for new trading facilities to handle the increased load. With a jealous eye on each other, they also are readying a variety of new trading "products," designed to appeal to investors and speculators. The most eye-catching of these are plans for futures trading in stock-market indexes—highly controversial because it will involve trading futures in something that, unlike a carload of wheat or $100,000 of Treasury bonds, can't be delivered.

Chicago's success with financial futures hasn't been lost on Wall Streeters. For one thing, Chicago is winning out in areas that seem more in New York's domain as the nation's financial capital. In contrast, the New York Stock Exchange fizzled when it moved into futures trading in 1980 by creating the New York Futures Exchange. To begin with, the NYFE flubbed by trying to copy markets already well served by the Chicago exchanges. But its main flaw has been its traders.

"NYFE lacks the large pool of professional traders who make the Chicago exchanges work so well," says Daniel G. Amstutz, the partner in charge of futures trading at Goldman, Sachs & Co. The Chicagoans, he explains, are willing day after day to lay their own money on the line, taking the kind of risks Wall Street stock traders aren't used to taking.

In an unusual move that may resuscitate the NYFE, the Chicago Board of Trade and the NYFE recently negotiated an agreement for an electronic linkup that would permit members of both markets to trade on either exchange. The main attraction for the Board of Trade may be a chance to trade futures based on the New York Stock Exchange Composite Index of some 1,530 common stocks. This would compete with the Merc's plan to trade futures based on Standard & Poor's 500-stock index and the Kansas City Board of Trade's plan to trade on the Value Line Index of 1,700 stocks. Some veteran Chicago traders grumpily question the Chicago Board's need to link up with the

Please Turn to Page 18, Column 2

Continued...

Futures Frenzy: Chicago's Hustling Young Traders Take the Lead in Broadening Commodities Markets

Continued From First Page

NYFE, and in any event they say it's too early to tell if the plan will work.

Strange as the alliance may seem, it's no more unusual than the Board of Trade's move to trade stock options after conventional commodities-trading volume slumped in the 1960s. Similarly, the Merc showed no hesitation in moving into financial futures when its traditional butter and egg business dwindled because of changes in the production and marketing of these farmyard commodities.

The traders who make the Chicago markets click are the inheritors of a long history of fabled market plungers making and losing huge fortunes, of manipulators and of bitter divisions between traders. Around the turn of the century, Joseph Leiter nearly cornered the wheat market on the Board of Trade, only to be driven out of business by Philip D. Armour, a great bear of the period. The last great battle, some old-timers say, was in the late 1920s when Arthur W. Cutten swamped the famous speculator Jesse Livermore with a 46-million-bushel avalanche of selling on the Board of Trade.

Commodities regulation is much stricter now, but there are still plenty of stories of big winners and losers among the speculators. At the top of the list, of course, are the oil-rich Hunt brothers of Dallas, who pumped millions of dollars into soybeans and silver in recent years. John F. Sandner, the chairman of the Mercantile Exchange, says he knows of a trader who made $50 million in cattle futures only to lose much of it last year in Treasury bill futures. And a legend at the Board of Trade is Eugene Cashman, an ex-policeman, who cleaned up in soybeans in the late 1960s and who still trades occasionally on the exchange.

Maseratis and Jaguars

One common characteristic of today's big hitters is their youth. Most of them seem to dress casually, tending toward jeans and open-at-the-throat shirts or flashy sportswear. They like to drive expensive foreign cars—Maseratis, Jaguars, and Rolls-Royces—and many have relocated along Chicago's Gold Coast and in Lake Forest and other ritzy suburbs.

Their workday is short but strenuous. On financial futures markets the trading is all over by 2 p.m. However, in the more popular trading pits, such as the Board of Trade's booming Treasury bond market, traders show up a half-hour before the 8 a.m. starting gong, just to find a spot where they can stand. And it isn't unusual to see someone get pushed to the floor when the trading intensifies.

"I have seen guys down there who would kill for an eighth of a point," says Lawrence J. Blum, a veteran of the Board of Trade and the CBOE, who may be only slightly exaggerating.

Some of the biggest clashes occur off the exchange trading floors. At the Merc, Mr. Melamed, who currently heads the National Futures Association, a self-regulatory organization of commodities firms, recounts how he led a faction of younger members to get the exchange to diversify and clean up a shabby image. The 133-year-old Board of Trade also has long been split into factions seeking to get the upper hand in running the exchange.

Disciplining Cargill

Speculators traditionally have fought the hedgers, with the speculators usually seeking looser trading rules. The hedgers—grain merchants and manufacturers or, in the case of financial futures, banks and other financial institutions—are generally in the market to lessen the risk of their trades in actual commodities by making offsetting trades in contracts for future delivery. By accepting these risks that the hedgers want to transfer, the speculators say they help provide the liquidity for efficient markets, thus economically justifying their role.

But this doesn't always ensure harmony between the two groups, which usually are trying to outguess each other on which way the market is going. In one of the Board of Trade's bitterest fights, Cargill Inc., the huge grain merchant, was expelled in 1937 after directors of the exchange accused the firm of attempting to corner the corn-futures market. Cargill continued to trade through brokers, but company officials were so angry about the expulsion that for several years they rebuffed the Board of Trade's invitation to return as a member of the exchange.

Chicago's traders also sometimes seem to divide along religious or ethnic lines, although these differences are probably not as great as they once were and Frederick G. Uhlmann, senior vice president of Drexel Burnham Lambert and a former chairman of the Board of Trade, says he doesn't think they are any more pronounced than "in any other industry."

Years ago, the Board of Trade was dominated first by Protestants and later by Irish Catholics. The number of Jews has increased considerably in recent times, traders say, pointing out that on several occasions since World War II Jews have been picked to head the exchange. The Merc, on the other hand, long has been dominated by Jews, but its Protestant and Catholic members have been increasing.

Peters Vs. Rosenthal

Cliques have gathered, as well, around strong-willed traders, as witness the election battles for the chairmanship of the Board of Trade. Two years ago, the scuffling centered around two controversial traders, Ralph N. Peters and Leslie Rosenthal. Both are shrewd and wealthy, but Mr. Peters has long been well-to-do, while Mr. Rosenthal started as a runner on the exchange.

When Mr. Peters was the chairman two years ago, many floor traders felt that he wasn't tough enough in fighting Washington's commodities regulators. So he was beaten in a reelection bid by Alfred H. Gruetzmacher, an ally of Mr. Rosenthal. Then Mr. Rosenthal a year later was elevated to the chairmanship despite heated opposition from traders who thought he had tainted the Board of Trade's reputation.

(Mr. Rosenthal's firm had been accused by the Commodity Futures Trading Commission of trading fraud, but the charge recently was dropped. Also, he had taken a large position in the wheat-futures market in 1979, which made him the center of a Board of Trade dispute with the CFTC, which was trying to tighten the trading rules.)

Recently, Mr. Rosenthal became embroiled in one of the exchange's bitterest internal feuds when he chose to run for reelection in opposition to Ralph Goldenberg, the candidate of the exchange's nominating committee, who usually wins. But Mr. Rosenthal won in a close vote. Anti-Rosenthal members were newly riled by the strong and secretive role he played in early negotiations to link the Board of Trade with the New York Futures Exchange. Both candidates sought to portray themselves as leading the fight against the Chicago Mercantile Exchange for dominance in the financial futures markets.

At the Board of Trade the membership also is divided over a plan of the new chairman, Mr. Rosenthal, to reorganize the exchange by splitting the market into subgroups — agricultural; government instruments; securities and indexes, non-governmental debt instruments and energy; and commodity options.

Members of the Merc also clashed among themselves recently over a plan to set up a new division to focus on new types of contracts such as stock-index futures and commodity options. At issue was a proposed stiff price for memberships in the new division, a price many longtime members felt they shouldn't have to pay. A recent vote, though, was lopsided in favor of the plan.

Frequently traders are at odds with the paid executives of the exchanges. Hard feelings developed recently against Robert K. Wilmouth, the president of the Board of Trade, when members were informed, belatedly they thought, of costly overruns on the expansion of their facilities.

At both the Board of Trade and the Merc, many traders are upset that the exchanges' officials didn't fight harder against the recent elimination by Congress of the commodities tax straddle. This was a strategy of trading in various contracts as a means of deferring federal income taxes. However, other traders are much less concerned, believing that they got a good trade-off from Congress, which lowered the top tax on futures-trading profits to 32% and eliminated the holding period for capital gains.

"The guys who are squawking are the ones facing huge tax liabilities for 1981," says one trader.

One of the stranger feuds is between the Board of Trade and its own offspring, the CBOE. Despite overlapping membership, the two often act like enemies. Recently the Board of Trade sued to block the CBOE from trading options in mortgage-backed securities, or Ginnie Maes. The Board of Trade wants to trade options on its own Ginnie Mae futures.

A Compromise Is Proposed

A proposed compromise calls for a joint venture, giving members of both exchanges common trading privileges in the disputed new options. Under the plan, each exchange would create a division where any contested new products such as options on futures contracts could be traded by both CBOT and CBOE members. The aim is to get around the problem of one exchange's getting an advantage over the other because the two are subject to different regulatory agencies. The Securities and Exchange Commission regulates the CBOE while the CFTC oversees the Board of Trade.

When the CBOE was started, older members of the Board of Trade resented the influx of newcomers to the new exchange, many of them New Yorkers who saw chances of making it big in options. The CBOE was plagued in its early days with trading abuses as volume soared and new options were added. To slow things down, the SEC in 1977 clamped on a three-year moratorium on the listing of new options.

The new exchange got hit from a different direction in February 1979, when federal agents raided the place to arrest several traders and clerks for dealing in cocaine.

Another source of discord is the stormy tenant-owner relationship of the CBOE with the Board of Trade. Because of heavy overcrowding, if for no other reason, the CBOE is looking forward eagerly to 1984 when it is scheduled to move into new $50 million quarters of its own.