cme
Chicago Mercantile Exchange

An Introduction to CME Equity Products

What Are Futures and Options?

Futures contracts are standardized, legally binding agreements to buy or sell a specific product or financial instrument in the future. The buyer and seller of a futures contract agree on a price today for a product to be delivered or settled in cash at a future date. Each contract specifies the quantity, quality and the time and location of delivery and payment.

The value of a futures contract is derived from an underlying financial measure or market, such as equity index levels, currency exchange rates, interest rates or commodity prices – hence the term *derivatives*. As the value of the underlying measure or market changes, the value of the futures contract based on that measure or market also changes. Institutions and individuals that face financial risk based on the movement of the underlying measure or market can buy or sell futures that will change in value to offset that financial risk. Such transactions are known as *hedging*. Institutions and individuals also buy and sell futures hoping to profit from price changes. These transactions are considered *speculation*.

CME also offers investors options on futures. Options can be thought of as insurance policies. The option buyer pays a price for the right – but not the obligation – to buy or sell a futures contract within a stated period of time at a predetermined price. The combination of options and futures – both risk-management tools – can give market participants the leverage of futures and the more limited risk of options. Options provide the opportunity to limit losses while maintaining the possibility of profiting from favorable changes in the futures price.

Global Leadership in the Financial Marketplace

CME is the largest and most diverse financial exchange in the world for trading futures and options – handling nearly 800 million contracts worth more than $460 trillion in a single year. Founded in 1898, we serve the risk-management needs of customers around the globe by offering the widest range of benchmark financial products available on any exchange, traded via our CME Globex electronic trading platform and on our trading floors.

Our innovative products cover major market segments – including equities, interest rates, foreign exchange, commodities and alternative investment products – and improve the way these markets work for customers everywhere. In addition, our clearing house matches and settles all trades and guarantees the creditworthiness of every transaction that takes place in our markets.

Overview of CME Equity Products

The advent of CME equity futures products in 1982 has enabled investors to effectively manage stock market risks, increasing their confidence and overall participation in these important markets. By serving as flexible, efficient risk management tools for managing equity exposure, CME equity futures have been instrumental in driving further growth and liquidity in the underlying stock market. In fact, many investors would be unwilling or unable to invest in stocks to the same degree they do today without the benefit of these products. This ability to efficiently manage equity market risk has contributed to the tremendous expansion of investor participation in equity markets over the past 20 years.

Equity futures are agreements to buy or sell the value of a specific stock index at a specific price on a specific date in the future. Because a portfolio including all possible securities would be too broad, cumbersome and expensive to track and measure, investors use stock indexes as benchmarks that measure the price performance of groups of stocks against the movement of the total market. CME equity futures closely follow the price movements of the underlying or cash indexes on which they are based. They offer an efficient, cost-effective alternative to trading stock index values or hedging against adverse market fluctuations without trading the actual stocks or indexes themselves in the securities markets.

CME is the dominant marketplace for equity derivatives. More than 90 percent of all U.S. stock index futures and options are traded at our exchange. It is one of the world's most liquid trading environments for equity products. With exclusive licenses for trading futures products based on the S&P 500 and NASDAQ-100 Indexes, CME offers the widest array of equity futures and options on futures products, which also include the Russell 1000 and Russell 2000 Indexes, the S&P MidCap 400 Index, and the Nikkei 225 Index. The CME equity futures product line includes full-size institutional contracts as well as smaller electronically traded (E-mini) versions that appeal to institutions and individual investors alike. CME E-mini S&P 500 and CME E-mini NASDAQ-100 futures are among the fastest growing futures contracts in the history of the industry. For a complete list of CME equity products, see page 8.

Why Use CME Equity Products?

The rapid price changes associated with investing in equity markets create trading opportunities, but also can generate tremendous risk. Since introducing our benchmark S&P 500 Stock Index futures contract in 1982, CME has been helping equity market participants transfer that risk. CME equity futures and options on futures contracts closely follow the price movement of their respective underlying indexes, providing risk management and investing opportunities for financial professionals and individual investors.

Hedgers and traders who purchase (go long) a CME equity index futures contract hope to gain from future price increases. Correspondingly, traders who initially sell (go short) CME equity futures hope to gain if the price of the contract declines.

For example, an investor with a diversified stock portfolio that is highly correlated with the S&P 500 Index could use CME E-mini S&P 500 futures to hedge or protect his or her portfolio against the financial impact of a short-term bearish market by selling (going short) CME E-mini S&P 500 futures. Using futures to achieve this protection is more cost efficient and less disruptive to the investor's portfolio than selling off portions of the positions of the hundreds of stocks that make up the portfolio. If the investor's market forecast is correct and S&P 500 Index decreases in value, the investor will buy CME E-mini S&P 500 futures later at a lower price. If the investor sells at a price that is higher than he or she paid, the transaction will be profitable. The investor's goal is to make a profit on the futures that can offset the loss on the actual stocks. If, however, the investor's forecast is incorrect and S&P 500 values increase, the investor will have lost on the futures purchase but hopefully benefited from increased value of the portfolio.