



MLA/SFE
CATTLE
FUTURES



A guide to using MLA/SFE Cattle Futures

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Note:

The examples included in this publication are for illustrative purposes only, and include certain assumptions regarding the liquidity and price behaviour of futures contracts.

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Introduction to futures

Coping with market uncertainty and price volatility is a constant challenge for the Australian beef industry. Many producers, lot feeders and processors accept this volatility as 'their lot'. However, this need not be the case.

MLA/SFE Cattle Futures and other price risk management tools can be used to protect against the risk of adverse price movements by securing prices in advance.

Businesses who manage their price risk have the advantage of being able to more accurately manage their financial affairs and, within an acceptable range of variables, predict the financial outcome of their business.

- Managing price risk is not about picking market highs and lows.
- It is about obtaining a degree of price certainty, irrespective of where the market goes.
- This protection gives you an increased ability to plan for business requirements, property expansion and family needs.
- Managing price risk can give you peace of mind.

What are futures?

A futures contract is an obligation to buy or sell a specific quantity and quality of a commodity on a specified future date. The only variable – the price – is determined by the futures market when entering into the contract.

Futures may be cash-settled (settlement by cash payment) or deliverable (settlement by delivery of the physical commodity). The MLA/SFE Cattle Futures contract is cash-settled only.

Futures contracts allow buyers to secure a buying price and sellers to secure a selling price for a commodity.

MLA/SFE Cattle Futures

The MLA/SFE Cattle Futures contract:

- is 5,000kg carcass (or dressed) weight of young cattle;
- is based on the Eastern Young Cattle Indicator (EYCI) (see box below);
- has six contract months (January, March, May, July, September, November);
- is cash-settled, meaning that settlement (at expiry) is by cash payment, not delivery of cattle; and
- is traded on the Sydney Futures Exchange.

MLA/SFE Cattle Futures allow hedgers to secure prices up to 18 months in advance.

More information on the cattle futures contract and the EYCI can be found in the brochures **MLA/SFE Cattle Futures Contract Specification** and **Eastern Young Cattle Indicator**, available from www.cattlefutures.com.au

Eastern Young Cattle Indicator (EYCI)

- A seven-day rolling average
- Vealer and yearling heifers and steers
- Grade score C2 or C3
- Live weight greater than 200kg
- 26 saleyards in NSW, Queensland and Victoria
- Expressed in cents per kilogram carcass (or dressed) weight (¢/kg cwt)

Who's who in the cattle futures market

Futures exchange

The futures exchange provides the trading platform and monitoring for the futures market. The exchange also establishes contract specifications and trading rules for futures contracts and disseminates market information.

The MLA/SFE Cattle Futures contract is listed by the Sydney Futures Exchange (SFE).

The clearing house

The clearing house guarantees the performance of every trade. It does this through **novation**, whereby the clearing house acts as counterparty for every trade (the seller for every futures contract bought and the buyer to every futures contract sold). The clearing house is also responsible for managing the margining process.

SFE Clearing Corporation Pty Limited (SFE Clearing) is responsible for the clearing operations for the MLA/SFE Cattle Futures contract.

Brokers

Brokers place buy or sell orders for their clients onto the futures exchange. Everyone who trades must have an account with a brokerage firm. Brokers place orders, collect margins, provide records and disseminate market information, charging a commission to do so.

Execution-only brokers are those that take orders and execute them in the futures market. Full-service brokers also execute orders, but will also provide advice.

Advisors

Advisors provide advice on using futures and other price risk management tools. A licensed futures adviser with knowledge of the cattle market will be able to advise you on using futures and help you put in place a price risk management strategy tailored to your enterprise and objectives. Advisors may also provide market information.

Speculators

A speculator has no underlying interest in either owning or producing cattle. Speculators attempt to make money by trading futures contracts, by speculating that prices will change to their advantage. Speculators play an important role in futures markets, as they offer liquidity for people looking to hedge.

Hedgers

Hedging is a process that involves buying or selling futures as protection against the risk of loss due to changing prices in physical markets. A hedger is someone who deals in a physical commodity and is looking to minimise and manage the price risk associated with that commodity.

Futures, forwards and OTCs

Futures, forwards and over-the-counter (OTC) products can all be used to manage price risk. The main differences between these products are the way they are traded and the market place where trading occurs.

The table below summarises the differences between futures, forward contracts and OTC products.

	Futures	Forward contracts	OTCs
Specification	Standardised	Flexible	Flexible
Settlement	Cash-settled or delivery of physical commodity	Delivery of physical commodity	Cash-settled
Regulated market	Yes	No	No
Price transparency	Yes	No	No
Counterparty	Multiple (through futures market)	Single	Single
Counterparty risk	No	Yes	Yes
Cash flow	Initial and variation margins	Full value of contract payable on maturity	Full value of contract payable on maturity

Hedging with cattle futures

The mechanics of hedging

Hedging is a strategy that is designed to **reduce risk**. Hedging is achieved by taking a position in the futures market that is as close to equal and opposite of the physical cattle position as possible.

In doing so, any unfavourable price movement in the cattle market will be offset by the profit achieved in the futures market.

Hedging involves a series of three transactions, one to open the futures hedge and two transactions to complete the hedge when the hedger wishes to sell or buy cattle (see following examples).

Holders of cattle futures contracts may 'close out' any positions they hold, at any time, by trading the opposite of their original futures position. Therefore, if they sold a January cattle futures contract, to close out they would buy a January cattle futures contract.

At the expiry of all cattle futures contracts, any remaining open contracts are settled against the EYCI as reported by Meat & Livestock Australia (MLA).

There are two types of hedger – one who is exposed to the risk that cattle prices will fall (eg a producer) and one who is exposed to the risk that cattle prices will rise (eg a meat processor). In some cases, hedgers may be exposed to different price risks at different times (eg a lotfeeder exposed to rising feeder cattle prices and falling finished cattle prices).

The simple examples that follow illustrate. These examples assume physical and futures market prices are the same. In reality, the relationship varies over time, and you must have an understanding of this relationship before using futures to hedge (more detail in next section).

The long and the short of it

- If you are long futures, you've bought a cattle futures contract.
- If you made a long hedge, you've bought a cattle futures contract to protect against prices rising. You plan to buy cattle later.
- If you are long cattle, you own cattle and plan to sell them later.

Long = To Buy

- If you are short futures, you've sold a cattle futures contract.
- If you made a short hedge, you've sold a cattle futures contract to protect against prices decreasing. You plan to sell cattle later.
- If you are short cattle, you need and plan to buy cattle later.

Short = To Sell

Cash market prices for cattle and cattle futures are closely correlated. Therefore, a fall in the cash price of cattle is generally accompanied by a fall in futures prices (and vice versa).

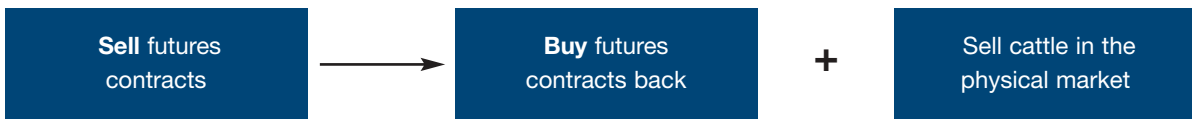
This relationship enables the mechanics of a futures hedge to work.

Using futures to protect against a price fall

A person wanting to **sell** cattle at a future point in time could seek to protect against falling prices by **selling** cattle futures. When the cattle are eventually sold in the physical market, they would simultaneously buy back the futures contracts to close out the hedge.

NOW

LATER



It is now July. A producer who has cattle to sell in November is uncertain about the price outlook. The November futures price is **310¢/kg** carcase weight (cwt) (**Target Price**). The producer would be happy to receive this price, so secures it in advance by selling November futures at **310¢/kg**.

Scenario 1 – prices fall

Cattle prices (and futures prices) fall to 270¢/kg cwt by November.

Scenario 2 – prices rise

Cattle prices (and futures prices) rise to 350¢/kg cwt by November.

	Physical market	Futures market
July	Expect 310¢/kg	Sell November cattle futures at 310¢/kg
Nov	Sell cattle at 270¢/kg	Buy November cattle futures back at 270¢/kg
Effective price	= price received ± futures gain/loss = 270¢/kg + 40¢/kg = 310¢/kg cwt (Target Price)	

	Physical market	Futures market
July	Expect 310¢/kg	Sell November cattle futures at 310¢/kg
Nov	Sell cattle at 350¢/kg	Buy November cattle futures back at 350¢/kg
Effective price	= price received ± futures gain/loss = 350¢/kg – 40¢/kg = 310¢/kg cwt (Target Price)	

In both scenarios, the producer was able to achieve the original target price, irrespective of the physical market price.

The income certainty achieved by knowing the sale price in advance enables sellers to plan and budget for their business with greater accuracy.

Using futures to protect against a price rise

A person wanting to **buy** cattle at a future point in time could seek to protect against rising prices by **buying** cattle futures. When the cattle are eventually bought in the physical market, they would simultaneously sell back the futures contracts to close out the hedge.

NOW

LATER



It is now July. A processor who has cattle to buy in November is uncertain about the price outlook. The November futures price is **310¢/kg** carcass weight (cwt) (**Target Price**). The processor would be happy to pay this price, so secures it in advance by buying November futures at 310¢/kg.

Scenario 1 – prices fall

Cattle prices (and futures prices) fall to 270¢/kg cwt by November.

Scenario 2 – prices rise

Cattle prices (and futures prices) rise to 350¢/kg cwt by November.

	Physical market	Futures market
July	Expect 310¢/kg	Buy November cattle futures at 310¢/kg
Nov	Buy cattle at 270¢/kg	Sell November cattle futures back at 270¢/kg
Effective price	= price paid ± futures gain/loss = 270¢/kg + 40¢/kg = 310¢/kg cwt (Target Price)	

	Physical market	Futures market
July	Expect 310¢/kg	Buy November cattle futures at 310¢/kg
Nov	Buy cattle at 350¢/kg	Sell November cattle futures back at 350¢/kg
Effective price	= price paid ± futures gain/loss = 350¢/kg – 40¢/kg = 310¢/kg cwt (Target Price)	

Again, in both scenarios, the processor was able to achieve the original target price, irrespective of the physical market price.

The certainty achieved by knowing the purchase price in advance enables buyers to plan and budget for their business with greater accuracy.

Basis - a key consideration

The relationship between physical and futures market prices is called **basis**.

Basis is calculated as the difference between the price of a physical commodity (cash price) and the futures price.

$$\text{Basis} = \text{Cash} - \text{Futures}$$

Basis is influenced by local supply and demand conditions, freight and other factors specific to a particular geographic location. Basis is also influenced by cattle type, quality and other animal factors.

Basis will impact the effectiveness of a hedging strategy. As such, it is important to know your basis and the relevance of futures to your business before using cattle futures to manage your price risk.

Using basis in hedging

The recurrence of physical market conditions gives rise to similarities in basis patterns over time. As such, it is possible to estimate basis as it is generally more predictable than cash or futures prices.

Knowing the basis expected for a specific time period enables hedgers to estimate the cash price they expect to receive at the conclusion of a futures hedge. This will allow them to evaluate whether or not hedging their price risk, at current futures market levels, will secure the price they need for their business.

Expected basis is estimated using historical basis data. However, it is important to note that these estimations are just that. While it is possible to estimate basis using historical data, basis does shift.

The risk that basis moves in an unexpected manner is called **basis risk**. Shifts in basis will impact on the actual price received or paid by the hedger.

Movements in basis

If basis becomes **more positive** (or **less negative**), it is said to be **strengthening**.

If basis becomes **less positive** (or **more negative**), it is said to be **weakening**.

For sellers, a hedging strategy protecting against falling prices will be more effective as basis strengthens and less effective as basis weakens.

Conversely, for buyers, a hedging strategy protecting against rising prices will be more effective as basis weakens and less effective as basis strengthens.

As basis shifts influence the effectiveness of a hedging strategy, it is critical for basis to be predictable in order to use cattle futures with confidence.

For more information, refer to the brochure **Back to Basis – the key to successful price management**, available from www.cattlefutures.com.au

Incorporating cattle futures into your business

There are five major steps required when considering using futures for hedging purposes. Importantly, be sure to keep a record of all your workings so as to be able to refer back if required.

1. Determine your risk exposure

Determine whether you are at risk if prices fall or if prices rise. For example, a cattle seller is at risk of prices falling whilst a cattle buyer is at risk of prices rising.

2. Estimate the basis between the cattle futures market and your physical market

Determine whether your cattle, or the cattle you need to buy, trade at a premium or discount to the futures price. How does your basis change over time? And is it predictable? This basis will impact on the success of your hedge, so an accurate estimation is critical. Your estimated basis needs to be incorporated into any of the calculations that you do.

3. Determine your profit margin over costs

Determine your break-even point based on your costs of production. Incorporate this with the profit margin you are happy with to generate a target price.

A successful hedge is one where the final net price (after profits/losses from using futures) closely matches the target price you calculated when entering into the futures market.

Guaranteeing a profit margin allows futures users to accurately budget and guarantee cash flow, thereby optimising long-term business profitability and financial viability while maintaining an adequate return on capital.

4. Determine how much of your cattle you want to hedge

Rarely would you lock in 100% of your total cattle to be bought or sold. You should discuss with an advisor to determine the optimal proportion to be hedged using futures.

Once this has been decided, determine the number of cattle futures contracts required to cover the proportion to be hedged.

5. Seek independent financial advice from a licensed futures advisor

Most importantly, you should seek advice from a licensed futures advisor to best understand the relevance of cattle futures and other risk management tools to your business.

Practical examples

The following section provides two examples illustrating how the MLA/SFE Cattle Futures contract are used by hedgers.

Example 1 – A person wanting to protect against falling prices

A cattle producer plans to have a deck of steers for sale in May. It is now September, and the producer is uncertain about the outlook for prices.

After analysing his costs and determining the required profit margin over break-even, the producer sets a target price for the hedged portion at 325¢/kg cwt. He estimates that the steers have a basis of 30¢/kg over the cattle futures market, so requires a futures price of at least (325¢ – 30¢, or) 295¢/kg cwt.

The May cattle futures price is 300¢/kg cwt, so the producer chooses to hedge a proportion of his production using cattle futures. Cattle are currently trading at 320¢/kg cwt.

Table 1 summarises how the producer would go about using the cattle futures market to hedge this production, and examines the results of several different scenarios.

Scenario 1 – Prices decreased

Let's say that physical cattle prices fell to 305¢/kg cwt in May. The hedge in this scenario has been effective. Had the producer not hedged any of his production, he would have received 305¢/kg. However, he exceeded his target price of 325¢/kg for the hedged portion of his production by 5¢/kg. The lower price in the physical cattle market was offset by the gain realised in the futures market through the hedge.

Scenario 2 – Prices increased

Let's assume that, rather than decreasing, prices in the physical market had increased to 345¢/kg. For the sake of this scenario, we will assume that the producer correctly estimated his basis and it didn't change over the life of the hedge.

You can see that in this case, if the producer had not hedged any of his production, he would have

received 345¢/kg for the cattle he hedged. However, the producer has still achieved his initial objective of price protection because the effective price still exceeded the target price of 325¢/kg.

Scenario 3 – Basis strengthened and prices decreased

Let's say the basis had strengthened from 30¢/kg over to 50¢/kg over. Had the producer not hedged any of his production, he would have received 305¢/kg cwt. However, the lower price in the physical cattle market was offset by the gain realised in the futures market through the hedge. Further, the effective price was higher than expected due to the strengthening basis. In fact, the price was increased by the 20¢ shift in basis (compared to scenario 1). In essence, the producer has gained from the strengthening in basis.

Scenario 4 – Basis weakened and prices decreased

Let's say the basis had weakened from 30¢/kg over to 15¢/kg over. Had the producer not hedged any of his production, he would have received 305¢/kg cwt. As in the previous scenario, the lower price in the physical cattle market was offset by the gain realised in the futures market through the hedge. However, the weakening basis reduced the effectiveness of the producer's hedge, causing the effective price to fall by the 15¢ shift in basis (compared to scenario 1).

From this example we can see that using futures does not necessarily remove all the risk, as the risk of basis strengthening or weakening is outside of the producer's control. However, it is important to realise that, generally, the basis risk is less than the risk the producer faced when not hedged.

Example 1. A person wanting to protect against falling prices				
Month	Scenario	Physical	Futures	Basis (Cash-Futures)
September		Expect 330¢/kg in April	Sell May cattle futures at 300¢/kg	Estimate 30¢/kg over (330-300)
May	1. Prices decreased	Sell at 305¢/kg	Buy May cattle futures at 275¢/kg	Actual 30¢/kg over (305-275)
		Result	Effective price = price received ± futures gain/loss = 305 + 25 = 330¢/kg cwt	
	2. Prices increased	Sell at 345¢/kg	Buy May cattle futures at 315¢/kg	Actual = 30¢/kg over (345-315)
		Result	Effective price = price received ± futures gain/loss = 345 - 15 = 330¢/kg cwt	
	3. Basis strengthened and prices decreased	Sell at 305¢/kg	Buy May cattle futures at 255¢/kg	Actual = 50¢/kg over (305-255)
		Result	Effective price = price received ± futures gain/loss = 305 + 45 = 350¢/kg cwt	
	4. Basis weakened and prices decreased	Sell at 305¢/kg	Buy May cattle futures at 290¢/kg	Actual = 15¢/kg over (305-290)
		Result	Effective price = price received ± futures gain/loss = 305 + 10 = 315¢/kg cwt	

Example 2 – A person wanting to protect against rising prices

A feedlot will need to purchase 1,000 feeder steers in November, for feeding for the Japanese market. It is now July, and the lot feeder is uncertain about the outlook for prices.

The lot feeder analyses the enterprise and calculates that in order to break-even and achieve a desired profit margin, the feedlot can pay no more than 310¢/kg cwt for the cattle.

In addition, the lot feeder estimates that the feeder cattle trade at a 5¢/kg discount to the futures market price.

The November cattle futures price is 315¢/kg cwt, so the lot feeder chooses to hedge a proportion of the feedlot's requirement using cattle futures. Cattle are currently trading at 320¢/kg cwt.

Table 2 summarises how the feedlot would go about using the futures market to hedge, and examines the results of several different scenarios.

Scenario 1 – Prices increased

Let's say that physical cattle prices increased to 340¢/kg cwt in November. The hedge in this scenario has been effective. Had the feedlot not hedged any of its feeder requirements, it would have been required to pay 340¢/kg for the feeders. However, by hedging the feedlot was able to obtain the target price of 310¢/kg. The higher price in the physical cattle market was offset by the gain realised in the futures market through the hedge.

Scenario 2 – Prices decreased

Let's assume that, rather than increasing, prices in the physical market had decreased to 290¢/kg. For the sake of this scenario, we will assume that the feedlot correctly estimated its basis and it didn't change over the life of the hedge.

You can see that in this case, if the feedlot had not hedged any of its feeder requirements, it would have been required to pay only 290¢/kg for the feeder steers. However, the feedlot has still achieved its initial objective of price protection because the effective price was still no more than the target price initially set.

Scenario 3 – Basis weakened and prices increased

Let's say the basis had weakened from 5¢/kg under to 20¢/kg under. Had the feedlot not hedged any of its production, it would have been required to pay 340¢/kg for the feeder cattle. However, the higher price in the physical cattle market was offset by the gain realised in the futures market through the hedge. Further, the effective price was lower than expected due to the weakening basis. In fact, the price was decreased by the 15¢ fall in basis (compared to scenario 1). In essence, the feedlot has gained from the weakening in basis.

Scenario 4 – Basis strengthened and prices increased

Let's say the basis had strengthened from 5¢/kg under to 10¢/kg over. Had the feedlot not hedged any of its production, it would have been required to pay 340¢/kg for the feeder cattle. As in the previous scenario, the higher price in the physical cattle market was offset by the gain realised in the futures market through the hedge. However, the strengthening basis reduced the effectiveness of the feedlot's hedge, causing the effective price to rise by the 15¢ increase in basis (compared to scenario 1).

Once again, it can be seen that hedging using futures has not removed all of the price risk, as the risk of a change in basis remains. However, the basis risk is less than the risk the lot feeder would have faced had they not used futures to hedge.

Example 2. A person wanting to protect against rising prices				
Month	Scenario	Physical	Futures	Basis (Cash–Futures)
July		Expect 310¢/kg in July	Buy July cattle futures at 315¢/kg	Estimate 5¢/kg under (310–315)
November	1. Prices increased	Buy at 340¢/kg	Sell July cattle futures at 345¢/kg	Actual 5¢/kg under (340–345)
		Result	Effective price = price paid ± futures gain/loss = 340 – 30 = 310¢/kg cwt	
	2. Prices decreased	Buy at 290¢/kg	Sell July cattle futures at 295¢/kg	Actual 5¢/kg under (290–295)
		Result	Effective price = price paid ± futures gain/loss = 290 + 20 = 310¢/kg cwt	
	3. Basis weakened and prices increased	Buy at 340¢/kg	Sell July cattle futures at 360¢/kg	Actual 20¢/kg under (340–360)
		Result	Effective price = price paid ± futures gain/loss = 340 – 45 = 295¢/kg cwt	
	4. Basis strength- ened and prices increased	Buy at 340¢/kg	Sell July cattle futures at 330¢/kg	Actual 10¢/kg over (340–330)
		Result	Effective price = price paid ± futures gain/loss = 340 – 15 = 325¢/kg cwt	

Getting started

Costs of using cattle futures

Commission and exchange fees

Commission will be charged by your broker for each contract bought and sold. The level of the charge should be negotiated between you and your broker prior to opening an account with the broker. In addition, exchange fees will be charged by the SFE (through your broker) for each contract you trade.

Margins

A key feature of futures markets is that the performance of each and every trade is guaranteed by the clearing house. In order to provide this guarantee, all buyers and sellers of futures are required to pay initial and variation margins.

An **initial margin** is required to be paid into your trading account with your broker upon the purchase or sale of futures contracts. This initial margin is a small percentage of the full value of the contract, and covers the maximum probable one-day move in the price of the futures contract. The initial margin is returned in full when the futures position is closed.

At the end of each day, the clearing house values all futures positions at closing market prices and compares them to the previous day's closing prices. This process is called '**mark to market**', and the difference between the two prices is called the **variation margin**.

If the price movement for the futures position is favourable, the variation margin is credited to your trading account by the clearing house. If the price movement is unfavourable, the clearing house requests the margin to be paid from your account. In this case, the variation margin is called a **margin call**. This margining process continues for the life of the contract.

If your trading account has insufficient funds to meet a margin call, your broker will request funds to be paid into your trading account. The broker may in fact request a sum to be paid that is greater than the individual day's variation margin, which will then be used to meet subsequent margin calls. The initial margin cannot be used to meet margin calls.

Other costs

The cost of lost interest on money paid to meet margin calls must be taken into account when determining your hedging costs.

In addition, cash flow is a very important consideration. Futures users must be able to meet margin calls in the context of normal day-to-day expenditure.

It is important to note that brokers are entitled to close out futures positions should their client be unable to meet margin payments. This may result in a loss to the client.

Example of margining process

Say you **sell** one MLA/SFE Cattle Futures contract today at 310¢/kg. You will be required to deposit an **Initial Margin** with your futures broker of, say, A\$425.

At the day's close the futures contract settles at 305¢/kg, indicating that you have made a gain on your futures position of 5¢/kg, or A\$250. This gain, or **Variation Margin**, is lodged to your account, bringing the balance for the day up to \$675. You decide to withdraw this gain from your account, leaving the initial margin of A\$425 intact.

Let's say on the following day the futures price settles at 310¢/kg indicating that your position has decreased in value by 5¢/kg or A\$250. This decrease in value will be subtracted from your account leaving a balance of A\$175. This is below the required initial margin amount of \$425 and you will be issued with a margin call to deposit a **Variation Margin** of \$250 with your broker to bring the account balance back up to the initial margin level. In reality, your broker will most likely request a lump sum to cover variation margins, rather than requesting smaller individual sums each time a margin call is required.

Brokers and advisors

Choosing a broker or advisor

All futures brokers and advisors are required to hold an Australian Financial Services (AFS) Licence. AFS licensees are responsible for ensuring that all representatives who provide financial product advice are adequately trained and competent to provide the financial services covered by its licence. You should always check that your broker or advisor holds the relevant AFS licence.

The type of broker that you choose will depend on the type of service you require in order to make your hedging decisions. A broker may provide financial advice and/or execution-only services. An advisor can only provide financial advice, however may be able to recommend a broker. It would be beneficial to contact a number of brokers to determine the nature of services offered and respective costs.

There are a number of things that you should consider when choosing your futures broker or advisor.

- Decide on whether you want a futures broker who is able to provide financial advice, or a broker who provides execution-only services. If the broker is not able to provide financial advice, you might wish to engage a financial adviser to discuss your risk management strategy.
- Obtain referrals from other futures users.
- Your stockbroker may have someone in their office licensed to trade commodities, or they may be able to recommend some licensed futures brokers or advisors for you to use.

Keeping records

When dealing with your broker or advisor, it is critical that good records are maintained.

When speaking with your broker or advisor, record the time and date of the discussion, the broker or advisor's name and what was discussed. In addition, check any broker statements carefully. In the event of a dispute, these records will be invaluable in a rapid resolution.

Placing orders

Before you can place an order with a licensed broker you must sign a client agreement form. **Read the documentation carefully** as it defines the legal relationship between you and your broker. It is your broker's duty to ensure that you understand your obligations completely before trading can begin.

One area that the client agreement form covers in detail is who can place orders. This is strictly controlled in futures markets.

Only a signatory to the client agreement documentation can provide orders (a partner in the case of a partnership, a member of the board or an employee in the case of a company or, if you are trading as an individual, only that individual).

Further, you can only give orders to someone who is an employee of an AFS licensee that is authorised to deal in futures.

Tracking your trades

"What's the current price?" is the most important question you must be able to answer when trading cattle futures. You can obtain MLA/SFE Cattle Futures price information from:

- MLA/SFE Cattle Futures website (www.cattlefutures.com.au)
- SFE website (www.sfe.com.au)
- Brokers or advisors
- Major daily and weekly newspapers

Order types and how to read prices

Order types

There are a number of ways in which you can give orders to your broker to achieve the type of order execution you desire. Shown below are some examples of orders that your broker may accept. However, you should discuss this further with your individual broker to assess which is most appropriate.

Market Order	An order to be executed immediately at the current market price.
Limit Order	An order that can be executed only at a specified price or better.
Day Order	An order that automatically expires if it is not executed on the day it is entered. Generally, orders are assumed to be day orders unless otherwise specified.
Open Order	An order that remains in force until the client informs it is to be cancelled, or until the contract expires. This is also called a “good ‘til cancelled” order.
Spread Order	An order to simultaneously buy one contract and sell a different contract at a quoted differential.
Stop Loss Order	An order that becomes a market order only when the market trades at a specified price.

How to read prices

So you’ve found a futures price. How do you interpret it? Below are some standard terms that will aid you in your understanding.

Bid	An indication to buy at a given price. This is the price at which participants can sell futures contracts.
Offer (or Ask)	An indication or willingness to sell at a given price. This is the price at which participants can buy futures contracts.
Open	The first traded price for the trading period.
High	The top price at which a contract was traded during the trading period.
Low	The lowest price at which a contract was traded during the trading period.
Settlement price	The official daily closing price set by the futures exchange for the purpose of settling margin accounts. This is typically set at the midpoint of the closing bid and offer.
Net change	The increase or decrease from the previous trading period’s settlement price.
Life-of-contract highs and lows	The highest price and the lowest price reached in the lifetime of a futures contract or a specific contract month.
Volume	The number of contracts traded (one side of each trade, only either buys or sells) during the trading period.
Open interest	The total of all currently outstanding contracts (one side only). Refers to contracts that have been entered into and not yet closed out.

Futures users can only sell or buy futures contracts based on the bid or offer prices, respectively. All other prices provide an indication of market history.

Glossary

Arbitrage	Simultaneous purchase and sale of two different contracts (or a combination of cash and futures) to take advantage of perceived mispricing. In a pure arbitrage, mispricing is locked in and a risk-free profit made through trades
Ask	See Offer
Basis	The difference between the price on the physical market and the futures price
Basis Risk	The risk that basis moves in an unexpected manner
Bear Market	A market in which prices are in a declining trend
Bid	An indication to buy at a given price. This is the price at which participants can sell futures contracts
Bull Market	A market in which prices are in an upward trend
Cash Settlement	Where settlement involves payment or receipt of the difference between the settlement price and the agreed future price
Close	The last traded price for the day
Close Out	To undertake a trade to offset an original futures trade. For example, a trade opened through buying futures contracts would be closed out by selling the same quantity of futures contracts (and vice versa)
Contract Month	The month in which cash settlement or delivery is to be made in accordance with a futures contract
Day Order	An order that automatically expires if it is not executed on the day it is entered. Generally, all orders are assumed to be day orders unless otherwise specified
Deliverable (Physical) Settlement	Where settlement involves delivery and receipt of the underlying commodity. Not applicable to the MLA/SFE Cattle Futures contract
Delivery Basis	Price difference between the physical and futures markets, due to differences between time of selling or buying in the physical market and time of expiry or close out in the futures market
Expiry Date	Settlement date
Futures contract	An obligation to buy or sell a specific quantity and quality of a commodity or security at a specified date in the future. The only variable, the price, is determined when entering into the contract
Geographic Basis	The price difference between the commodity sold in a particular area and the commodity underlying the futures contract
Good till Cancelled Order	See Open Order
Hedge	To take a position (ie buy or sell) in the futures market as a means of reducing price risk in the physical market
Hedger	A person who deals in the physical commodity, and is looking to minimise or manage price risk
High	The top price at which a contract was traded during the trading period
Initial Margin	A small percentage of the trade value to be paid to the broker upon the purchase or sale of futures contracts. This will be the minimum balance of your trading account
Last Trading Day	The final day during which trading may take place in a specified contract month
Life-of-Contract Highs and Lows	The highest price and the lowest price reached in the lifetime of a futures contract or a specific contract month
Limit Order	An order that can be executed only at a specified price or better

Long	When futures contracts have been bought or the unhedged physical commodity is held
Low	The lowest price at which a contract was traded during the trading period
Margin	Cash or equivalent posted as guarantee of fulfilment of a futures contract (not a down payment)
Margin Call	A request to cover an adverse price movement on a futures position
Market Order	An order to be executed immediately at the current market price
Marking to Market	The practice of crediting or debiting a trading account based on the daily closing prices of the futures contracts
Market Maker	A market participant who provides a bid and offer quote that, when there are no better bids and offers, allows futures users to enter into or exit out of futures positions at a reasonable price. Market makers may provide quotes on a continuous or “request for quote” basis
Net Position	The difference between the open contracts long and the open contracts short held in any one commodity by any individual or group
Net Change	The increase or decrease from the previous trading period’s settlement price
Novation	The process by which SFE Clearing acts as counterparty for every trade, ie is a buyer for every futures contract sold and a seller for every futures contract bought
Offer	An indication or willingness to sell at a given price. This is the price at which participants can buy futures contracts
Open	The first traded price for the trading period
Open Interest	The total of all currently outstanding contracts (one side only). Refers to contracts that have been entered into and not yet closed out
Open Order	An order that remains in force until cancelled or until the contract expires. This is also called a “good till cancelled” order
Open Position	A position where futures have been bought or sold and not closed out
Over-The-Counter (OTC)	A product tailored to meet the individual users’ requirements
Quality Basis	The price difference between the commodity underlying the futures market and the commodity being hedged (eg due to difference in cattle type or quality)
Range	The difference between the high and low price of the futures contract during a given period
Settlement Price	The official daily closing price set by the futures exchange for the purpose of settling margin accounts. This is typically set at the midpoint of the closing bid and offer
Short	When futures contracts have been sold
Speculator	A person entering into futures contracts for any purpose other than hedging. One who attempts on the basis of existing conditions to anticipate price changes and to trade accordingly in order to make capital gains
Spot Price	Current price at which the commodity or futures contract is trading
Spread Order	An order to simultaneously buy one contract and sell a different contract at a quoted differential
Stop Loss Order	An order that becomes a market order only when the market trades at a specified price
Variation Margin	The difference between the daily settlement value and the previous day’s value, as determined by the process of marking-to-market. This is paid to the broker when the futures price is less favourable for the client, and paid to the client’s trading account when the futures price is more favourable for the client
Volume	The number of contracts traded (one side of each trade, only either buys or sells) during the trading period

More information

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