Part 1:

Futures Markets - How did it all start?

This is the first in a six-article series on how to trade futures, brought to you by Bursa Malaysia Derivatives Berhad (BMD) and OSK Investment Bank Berhad, in conjunction with BMD's 'Talk Futures' campaign aimed at creating awareness and educating investors on derivatives trading.

Globalization has made markets more accessible and investing one's money in them more achievable for almost all individuals in the 21st century. There are many ways one could go about investing. Some may prefer their portfolios to lean slightly towards equities (stocks) and some weigh a little on bonds or other fixed income securities. In this interconnected globe, many different combinations are possible; and that includes investing in the futures markets.

Futures markets have been around for a very long time. It goes as far back as to the times of Aristotle where he wrote a story about how a poor philosopher named Thales from Miletus (Turkey) developed a "financial device, which involves a principle of universal application".

Thales is known for using his talent to forecast the olive harvest. His confidence led him to agree with the local olives owners to deposit his money with them now, to guarantee him the exclusive use of the harvest once it was ready.

Thales got himself a low price for the harvest because since the harvest will only happen at a later date, no one could possibly know the outcome of that harvest; and so, the local olive owners were prepared to take up on Thales's offer because they can then hedge against the possibility of a bad harvest.

When the harvest time came, the demand for olives shot up and Thales sold them at any rate he pleased. In the end, he made himself a lot of money. The story of Thales proves that the principle of futures markets have been here for a long period of time.

In 1864, The Chicago Board of Trade listed the first ever standardized exchange traded futures contracts. It started off with trading grains futures but slowly gain popularity in other types of commodities later on during the years.

So what are Futures Markets?

Fast forward to the present day, financial instruments have been cleverly developed and improved. Futures trading today are more comprehensive as compared to the olden days after the advancement of new technologies and also due to the complex development of investors' psychology.

With increasing numbers of businesses taking up on more risks in today's ever-so competitive economy, an instrument such as Futures is needed and used by these businesses to hedge against probable risks.

The size of the listed derivatives market globally is estimated to be nineteen times the size of the global economy. To put it tangibly, that is a notional value of $1380 trillion worth of listed derivatives in 2010 as compared to the global economy which is about $74.5 trillion as of year 2010.

This could only mean that opportunities are there for the taking. With a market this gargantuan, the probability to profit from trading derivatives, e.g. Futures, could be more prolific than trading in some other duller and more saturated investment vehicles. As of year 2010, of all the 78 derivatives exchanges around the world, the global volume for Futures trading ticks well over $11 billion.

There are largely two categories in Futures and it can simply be segregated into financial futures and commodity futures. In financial futures, one can trade interest rate products such as: Eurodollar Futures, U.S. Treasury Futures (treasury bonds and treasury bills), Foreign Government Debt Futures, Interest Rate Swap Futures, FOREX Futures; Stock Futures and Index Futures (S&P 500 Index, Nasdaq-100 Index, Dow Jones Industrial Average, Single Stock Futures and Volatility Futures).

In commodity futures, an individual can choose from a variety of different products ranging from Metal Futures such as the popular Gold and Silver; Energy Futures such as crude oil and natural gas; grains and soil products like corn, soybeans and wheat; livestock products like live cattle, lean hogs and pork bellies; and food and fiber products such as cocoa, coffee and sugar.

However, before one starts delving on how to get started in the Futures markets; it is important that one first grasps the fundamentals of how these markets work. The next part will cover the mechanics of how futures work, who are the main players, as well as the profit opportunities available.