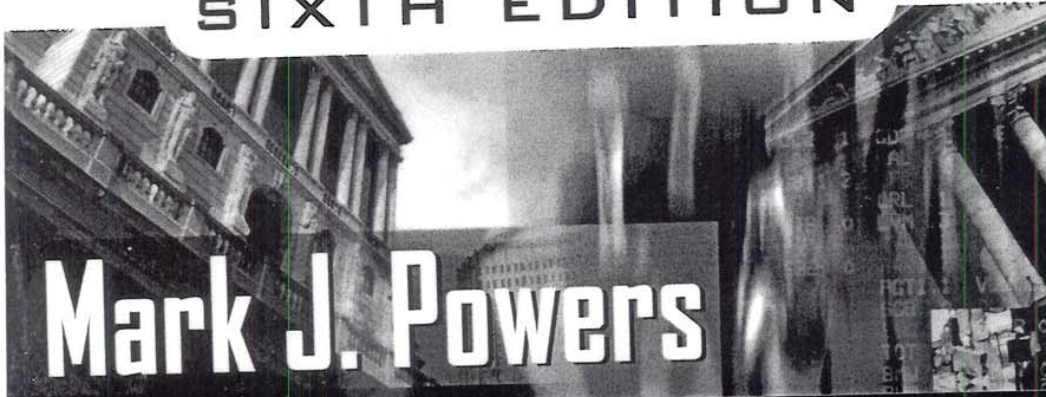# Starting Out in
FUTURES TRADING
SIXTH EDITION

Mark J. Powers

Starting Out in Futures Trading

Updated and Expanded

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Throughout the book the author is using "he" but it is meant to imply
a neutrality in the sexual context and should be read as "he or she."

directly. Instead, they each deal exclusively with the clearinghouse. In effect, they are now long or short to the clearinghouse, because it has assumed the position of second party to each member's transaction. The liquidation of contracts is facilitated through this system, because a trader can now offset his contract without the necessity of obtaining the agreement of the original second party to the contract. The clearinghouse then merely notes that the original trader's obligation is canceled.

The clearing member firm is ultimately responsible for fulfillment of a contract with the clearinghouse, not the individual customer. The customer's responsibility lies solely with his broker. The brokerage firm, after executing the trade, then deals exclusively with the clearinghouse.

FINANCE

Whenever a transaction is made in the market, both parties to the trade are asked to post a "good faith" bond in the form of cash, Treasury bills, listed securities, or letters of credit. This "good faith" money is usually referred to as margin, although on some markets it is called a "security deposit," a term which more accurately describes it and distinguishes it from margin in the securities market.

The clearinghouse establishes and maintains strict control over these minimum security deposits (margins), both for initiating and for maintaining positions. Member firms are required to collect these minimum amounts from customers. Brokers may, and frequently do, charge customers more than the minimum, but they may not collect less. Clearing member firms must, in turn, deposit and maintain a specified level of funds in the clearinghouse to back up their aggregate net market position.

The purpose for requiring these funds is to ensure performance under the terms of the futures contract. It is a safeguard or surety to both buyer and seller (and to the carrying broker) that there will be funds available to make proper settlement when the contract is terminated. When the contracts are offset or delivered upon, this money is returned to the trader along with his profit on the transaction, or is applied toward his debts if the trader has lost money.

Traders who have a paper profit on their transactions may withdraw their gains over and above the minimum security deposit required at any time before they offset their positions. On the other hand, if their transactions show a paper loss, their accounts will be debited accordingly, and they may be asked to deposit additional funds in order to maintain the value of their accounts at the required minimum amount.

The clearinghouse requires daily settlement in cash for all price variations in every contract traded. This means that each day the clearinghouse credits the account of clearing members showing a net gain due to favorable price move-

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