Capitalize on the CME Group/MexDer Partnership

Trade MexDer Equity Index (IPC) Futures

CME Group | MexDer

Open a New Door to Opportunity with MexDer Equity Index (IPC) Futures

The CME Group and MexDer partnership has made it easier than ever to trade cross border Exchange Traded Derivatives (ETD's), with direct access to MexDer's IPC (Mexican Exchange Index) futures. Traded and cleared through MexDer, and now available on the CME Group trading platform, these contracts provide an efficient way for asset managers, mutual funds, proprietary traders, and hedge funds to manage risk and access opportunity in one of the world's fastest growing economies.

About MexDer and the CME Group/MexDer Partnership

MexDer is the derivatives subsidiary of the BMV Group, the financial exchange operator in Mexico, and the leading market place for trading derivatives on Mexican benchmarks. The Mexican Exchange, also part of the BMV Group, is Mexico's only stock exchange and represents roughly US$ 700 billion in capitalization. It is the second largest stock exchange in Latin American and the fourth largest in North America.

In 2011, CME Group and MexDer joined forces, linking their trading platforms and providing easy access to a growing portfolio of derivatives products in two thriving marketplaces. The CME Group/MexDer partnership benefits customers from Mexico wishing to trade CME Group products (South-to-North) and US based customers wishing to trade Mexican derivatives (North-to-South). Regardless of trading direction, all customers benefit from the safety and security of central counterparty clearing.

Trading the benchmark for the Mexican market

IPC futures are contracts based on the Mexican Exchange Index, a capitalization-weighted index of common stocks traded on the Mexican Exchange. The index is made up of shares selected from various sectors and is designed to reflect activity across the entire Mexican economy.

Key Benefits

- **No local presence required in Mexico**
- **High correlation to S&P 500 and Bovespa (Brazil) Indices**
- **Remote Membership**
- **CFTC approved products**
- **Co-location**
- **Collaterals accepted in US**
- **Omnibus Accounts: Rule 30.7 (CFTC) segregation**
  - **One for proprietary trading**
  - **One for customer trading**
- **Give ups**
  - **FIA standard agreement**

Product Details

Contract: $10 MXN x IPC Index

Example: IPC = 36720 has a notional value of $MXN 367,200

Assuming a MXN/USD conversion rate of 0.08635, the USD equivalent would be roughly $31,708 per contract. Comparatively the CME S&P 500 E-mini futures would be $66,787.

Cash settled and offered quarterly

Tick Size: 5 points, or $50 MXN, or converted roughly $4.31 USD compared to CME S&P E-minis at $12.50 per tick.

Current ADV: Approximately 5,000 contracts with Open Interest above 85,000 since 2010. Implied volatility as derived from the options on futures is approximately 20.8%.

Spread trading opportunities

Spreading one equity index futures contract against another is a common and effective way to harness trading opportunity as well as mitigate risk. It can be a useful trading and hedging strategy for both portfolio managers and speculative traders alike.

Spreading the IPC against the S&P 500 E-mini

When working with and evaluating equity index contracts, it's important to understand how each product works: its specifications, its underlying index and its notional value. S&P 500 E-mini contracts traded at CME Group are based on the Standard & Poor's 500 stock index, the benchmark index for most U.S. funds and advisors. The E-mini futures contract is cash settled and trades in a quarterly contract cycle with March, June, September and December expiration months. The E-mini's notional value is a simple calculation:

P futures x multiplier = Notional Value

For example: on June 3, 2011, the S&P 500 E-mini futures closed at a price of 1296.25, which using the formula above along with the contract multiplier of $50 results in a notional value of $64,812.50 per contract. The notional value is the dollar amount represented by one futures contract. Because the multiplier is fixed but the futures price can fluctuate, the notional value changes with market price moves.

The Mexican equity market benchmark is the IPC index, and the futures contract based on it is traded on MexDer. The IPC contract has a multiplier of $10 MXN and trades in quarterly cycle months identical to CME Group's S&P 500 E-mini contract. The MexDer IPC futures notional value follows the same formula as E-mini's. IPC futures closed June 3, 2011 at 35137. When plugged into the formula:

35137 x $10 MXN = $351,370 MXN per contract

To compare and spread between these equity index contracts, we must first convert the MexDer IPC notional value to dollars. Assume a USD/MXN rate of 0.083375, which is roughly 12 pesos per $1 USD. Based on the closing values above the MexDer IPC futures (symbol = ISM1 on Bloomberg) with a MXN$ notional value of 351,370 x currency conversion rate 0.083375 = $29,295 USD equivalent. The CME Group S&P 500 E-minis from the same closing date produced a notional value of $64,812.50 per contract. For our purposes, we will apply the common formula for a dollar weighted spread, or hedge ratio using equity futures contracts by dividing the notional value of the E-minis by the dollar adjusted notional value of the IPC futures or:

NV (E-minis) / NV (IPC) = hedge ratio
64812.50/29295 = 2.2124 or roughly 2:1 IPC futures per E-mini

Let's look at an example of how this works.

After trading sideways for several weeks on 12/13/2010 the S&P 500 Index, as represented by the CME S&P 500 E-mini futures for June delivery (ESM1), broke out to the upside. If a trader wanted to go long the ESM1 but with a hedged or spread position, one option would be to sell the ISM1/ESM1 spread on a 2:1 basis. Selling 2 IPC futures contracts on MexDer and simultaneously buying 1 S&P 500 E-mini contract on the CME. When the ISM1 contract is viewed versus the ESM1 on that date, you may detect a diverging daily price change pattern.

Exhibit 1

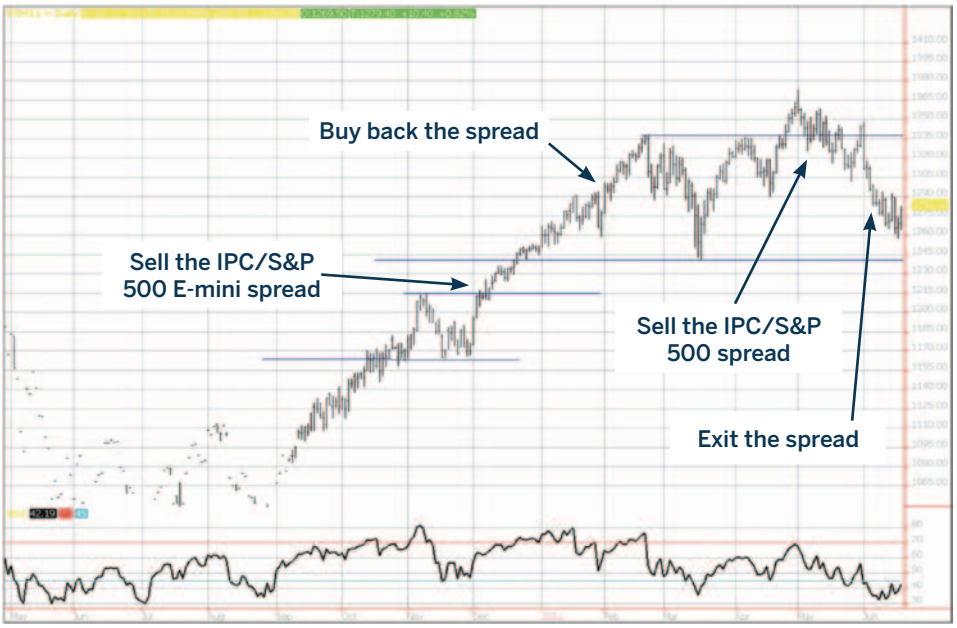
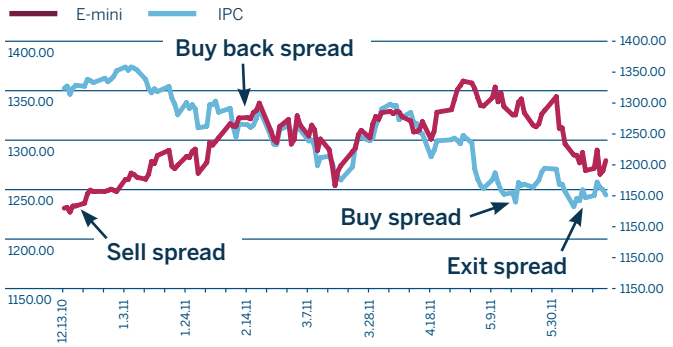


Exhibit 2: June IPC/June E-mini



ESM1 (in red) was in a price rising trend while ISM1 was in a flat to sideways pattern (see Exhibit 2). Going forward the S&P Index continued to trade higher in price into 2011, but the spread between ESM1 and ISM1 narrowed, and the two equity index contracts settled into a similar consolidation or sideways price pattern. With the spread narrower and the price action between the contracts more closely correlated, it would be a good time to unwind the spread trade, selling the ESM1 and buying the ISM1.

P&L ANALYSIS

12/13/10 Bought 10 ESM1 at 1231.25
Sold 20 ISM1 at 38475
Dollar weighted spread = 1.0416

2/8/11 Sold 10 ESM1 at 1316.75
Gain of 85.50 points x $50 x #contracts = $42,750

Bought 20 ISM1 at 37830
Gain of 645 points x $10 x #contracts = $129,000 MXN
Converted at 0.083375 = $10,755 USD

Dollar weighted spread = 0.9576

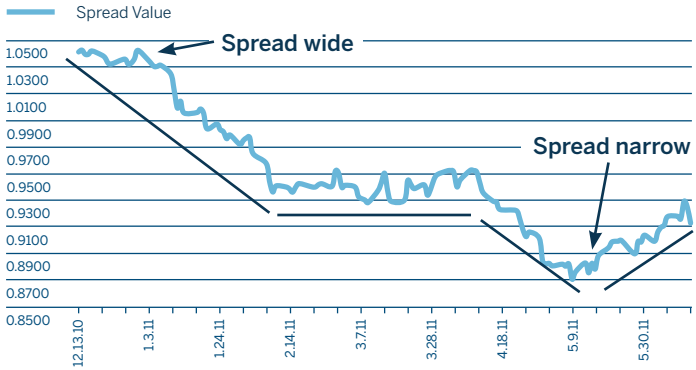
Total gain for the position $53,505 versus an outright long ESM1 gain of $42,750.

Dollar weighted spread calculated as notional value of (2 x IPC)/(1 x ES)

Deciding when to act

Determining the ideal time to enter and exit this type of spread relationship is subject to debate, and market participants should investigate their options and apply their own models for evaluation. One possibility is to look for price distortions or a widening and narrowing of the spread compared to the outlook in one or the other indices for clues.

Exhibit 3: Dollar Weighted Spread



This spread chart indicates a sideways pattern that coincides with the closely correlated price activity of each respect index (compare to Exhibit 2). When the spread moves out from the sideways pattern, possible trading opportunities present themselves.

On 4/28/11, the ESM1 again broke out of sideways channel to the upside (see Exhibit 1). This time the ISM1-ESM1 spread was narrow and pricing action diverged where by the ISM1 was trending lower and ESM1 was trending higher. By 5/16/11, the ESM1 broke back through support after failing to maintain higher highs on greater volume. At the same time, the ISM1-ESM1 spread had narrowed even further presenting a possible spread trade this time buying ISM1 and selling ESM1 2:1 at a spread of 0.8826.

By 6/3/11, the spread had widened but the trade was into the delivery month for both contracts. At this point, three options are available:

1) exit the position by off-setting each leg of the spread,

2) roll the position forward by executing calendar spreads in each contract, or

3) continue with an open position with the knowledge that last trading day (LTD) is rapidly approaching.

Evaluation option 1 results in the following:

P&L ANALYSIS

5/16/11
Bought 20 ISM1 at 35097
Sold 10 ESM1 at 1325.50
Dollar weighted spread = 0.8826

6/03/11
Sold 20 ISM1 at 35137
Gain of 40 points x $10 x #contracts = 8,000 MXN
Converted at 0.083375 = $667 USD

Bought 10 ESM1 at 1296.25
Gain of 29.25 points x $50 x #contracts = $14,625

Dollar weighted spread = 0.9035

Total gain for the position $15,292 versus outright short ESM1 gain of $14,625.

Dollar weighted spread calculated as notional value of (2 x IPC)/(1 x ES)

Spreads and Relative Value

Spread trading takes into account the relative value between two contracts. Understanding the relative value of a contract requires an understanding of its pricing mechanism. IPC futures provide another tool for equity managers and traders. Spread trading between IPC and S&P 500 E-mini futures is another option for risk management and speculative traders.

Moving forward

With greatly expanded access now available through the CME Group/MexDer partnership, we anticipate substantial growth across both trading platforms in the years ahead. Spread trading is just one of the ways active traders and portfolio managers can capitalize on the opportunity and deeper liquidity created by this new partnership.

For more information about spread trading and additional opportunities now available to CME Group traders, please contact us today!

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