

EXPIRING MONTHLY

THE OPTION TRADERS JOURNAL



Expiring Monthly Interview with

Tim Andriesen

Managing Director, Agricultural Commodities

CME Group

Mark Sebastian



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Tim Andriesen was appointed Managing Director, Agricultural Commodities of CME Group in August 2009. He is responsible for developing and executing the global business and sales strategy for the company's agricultural commodities product line.

Prior to joining CME Group, Andriesen most recently served as Managing Director, Agribusiness for National Australia Bank/nabCapital in New York. He also worked as Managing Director, Commodities/Commodities Sales in the firm's Sydney office and as Senior Vice President of Commodities based in New York. His background also includes senior risk management and agricultural trading roles with Zurich Capital Markets, Louis Dreyfus Corporation, Rabobank International and Koch Industries.

Andriesen earned a bachelor's degree in marketing with a specialization in international business from Southern Illinois University.

I don't think any trader can argue that over the last few years, commodities have increasingly become a part of institutional traders' portfolios. Even more recently, the retail public has gotten involved in commodities as well. With events like Russia canceling all exports of wheat, droughts and floods in the Midwest, and gold reaching all time highs, I thought it would be interesting to sit down with an Tim Andriesen, Managing Director of Agricultural Commodities for the CME Group, to talk about commodities: how they are traded now, what makes them tick, and what products might be coming down the pipeline.

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Expiring Monthly: *Can you tell us a bit about your current position and your background?*

Tim Andriesen: I am the Managing Director of Agricultural Commodities and Alternative Investments. I've been with the CME Group since August of last year. I spent about 16 years trading cash grains through the U.S. and in Mexico. In 1996, I went to work for an energy company that was in the agricultural space as well. I spent one of my years there running an agricultural over-the-counter (OTC) option desk. When the company got out of that business

I went to New York and worked for financial institutions running commodity OTC businesses and desks. Most recently, I ran the commodities business for National Australia Bank. I have experience on both the user and OTC side when it comes to options.

EM: *What are CME Group's strengths with commodity options?*

TA: There are two areas of strength, and it depends on what you are trying to accomplish. In the physical world where you have people who are trading physical commodities, one is typically using options to build a minimum or maximum price into a hedging program.

If you're a farmer, you have a couple options. You can either deal directly with the exchange or, very commonly, grain merchants—who are buying the commodity that you are using. They will have a maximum or minimum price contract with you. In recent years, we have seen a growth in trades that are not simple vanilla-type minimum or maximum price contract. Farmers are reaching into the OTC markets where they are developing more complex structures using OTC options, things like average price options that allow you a maximum price but to participate in the average



price over some window or a barrier structure, things that bring more pricing flexibility. On the commercial side, what you are seeing is these products used as part of a physical transaction or as part of a hedging strategy by a firm.

On the other side, on a speculative basis, what I think is interesting to people about commodity options is that they are liquid and have deep option markets and also term structure. You see good liquidity going out over the course of the year and there is distinct seasonality on the commodities market. You have this concept of “new crop” and “old crop” where one crop is almost all consumed and the next month a new harvest will change the dynamics of the marketplace. Some of the things you see are the definitive parameters and definitive behavior as one moves out on options curve.

For instance, one of the really interesting things that we’re doing is now offering exchange-traded options on spreads. Going back to the “old crop/new crop” concept, the November soybean futures are generally considered the “new crop” bean contract. Two years ago, we started offering options on the July/November spreads. We’ve continued to grow, offering options on spreads within the same commodity and recently we started to expand into

offering options on spreads across different commodities. We recently listed options on the corn/wheat spread. We are about to list options on the corn/soybean ratio. This is interesting because one of the key drivers of these markets is that year’s allocation of acreage between corn and soybean production.

EM: *What are some common misconceptions about commodity options? What would make the general public think commodity options are a useful and interesting product beyond what you just said?*

TA: Historically, investing in commodities is something the general public has not looked at as many thought commodities were too speculative. In reality, they are grounded markets, reflecting supply and demand of real things. The general public is just starting to look at commodities as a mainstream investment opportunity. Commodity options have only been around since about 1984. They are reasonably new products to many people.

EM: Let’s talk a little about the micro-product. That micro-gold contract (MGC) has come out and my understanding is that it is popular. Does the CME have any plans to roll out more of these micro-products to get a lot of the retail trading or some people that don’t want to trade a normal sized

contract? Is that something the CME is looking towards pushing?

TA: Within the agricultural space, one of the key things for us is to develop products for hedgers. We think that if you have that core hedging business underlying the marketplace, it provides that supply and demand and brings about good liquidity. We simply don’t get a lot of demand for smaller sized contracts from our core commercial customer base. We haven’t been looking too hard in trying to downsize our contracts.

EM: *What Products is CME Group looking to roll out in the future?*

TA: We are always evaluating new products and services to meet the financial risk management needs of our global customers. One thing we are hearing from our customers is options on oil shares. If you think of the “crush,” buying soybeans and crushing it into meal and oil, one of the drivers of that is how much of that revenue is coming from oil. We’re getting a decent amount of demand for an option on the oil share. It sounds a little esoteric but it plays a bit when demand for bio-fuels changes. Demand drives the crush. We think that people are looking at that space and have a view. This gives them a way to express that view.

EM: *What about the industry as a whole? How is the industry changing*



right now? Is it more of these personalized products or are there any kinds of radical changes that are really beyond going electronic? Is the industry changing in any way that strikes you?

TA: I think the one thing that we are all trying to look at is how the OTC markets come into play in the post Dodd-Frank environment. There is certainly a wide array of options that are available in these OTC markets. Historically, they haven't been something that have been targeted to the retail investor and I don't know if I would see that. But certainly the institutional investor, to the extent that those products become cleared OTC products, it may open the door up for them to trade things that are a little more than the fairly vanilla things that exist on the exchange today.

EM: With options on the different grain products, is there an area where they are competing with the futures or is this a purely supplemental product where they both increase the volume?

TA: I think definitively they both provide strong volume and open interest because, generally speaking, market makers are hedging some of their risk in the futures. From our customers, I don't see too many people that, from a large volume, are saying, 'I want to switch from futures to trade options because I think it's an alternative.' I think the mindset between these two markets

is fundamentally different. If you're trading options, you're probably doing it for one of two reasons. You either are looking for a limited risk, unlimited reward trade, or you have a view on volatility that you are trying to express. It's generally not an efficient thing to do to try to absolutely express a directional point-of-view using options. From the users that we deal with, I think they tend to be synergistic, and I don't really think the people who are trading options are going away from trading futures. They have very different objectives in mind.

EM: How correlated is volatility across the agriculture sector or the different commodity sectors?

TA: It depends on the commodities. For example, if you look at corn and soybeans, they tend to be grown in the same places at the same time. Generally something that would drive higher volatility in corn would also drive higher volatility in soybeans, soybean meal, and soybean oil. Wheat would be a little less connected but would have some of the same drivers. If you looked at the correlation in volatility between corn and cattle, it would be more disconnected. They all have some connections with each other but it really depends on what two you are looking at.

EM: What are your general thoughts on the commodity ETFs?

TA: I can't say that I have a particularly strong view about the ETF market. There are probably customers for whom an ETF probably makes more sense. There are also customers for whom investing directly in futures makes more sense.

EM: Are there any closing thoughts you would like to give our readers?

TA: The one thing I would say about commodity options in particular and probably options in general is that when people are looking at trading options, they need to recognize that you get what you pay for. People look at premium and say, 'Well that's expensive.' It is expensive because that is the expected payoff of the option. A lot of people get stuck into the 'I want to buy something cheap' mentality. A lot of times what they find is that buying things cheaply does not give them what they are looking for. We really have no skin in the game whether somebody buys a deep in-the-money option or an out-of-the-money option. What we want are customers to have good experiences. One of the key things I always try and point out whenever I'm talking about options to customers is that you really have to recognize that the option markets tend to be efficient. If they are expensive, there is a reason for that. If they are cheap, there is a reason for that, too.

EM: Thanks for your time, Tim. **EM**

