CME Group

Keeping Abreast of Events

HOW TO TRADE CME GROUP FINANCIAL PRODUCTS BASED ON RECENT POLITICAL AND ECONOMIC EVENTS

JULY 10, 2014

ASIA RESEARCH TEAM
CME GROUP

Political and Economic Uncertainties

Financial futures prices are highly sensitive to political and economic developments in the regional and global markets. There have been many, and there will be more, in 2014.

CME Group offers the most liquid benchmark contracts for investors seeking an investment exposure to macroeconomic events. Our average daily trading (ADV) volumes reached a record high of 17 million lots in June 2013, and volumes remain very healthy at 13 million lots year-to-date. So far this year, GBP/USD has hit record volumes on CME's platform on June 12, with 337,633 futures contracts traded.

Recent events which the market has been closely monitoring include the FOMC meeting in the US, the roll out of the Japanese Prime Minister's Abenomics, military activities in the Ukraine and violence in Iraq, fears of an economic slowdown in China, Indian Prime Minister Modi's economic plan and Budget, the Indonesian elections, just to name a few.

FOMC decisions affect the outlook on interest rates, stock markets, foreign exchange rates and gold prices, not only in the US but also in Asia. Asia investors cannot afford to neglect the impact of the US Federal Reserve's (Fed) decisions. CME has benchmarks on all the relevant asset classes for investors to express a view on such events.

Yellen, the Flavor of the Day

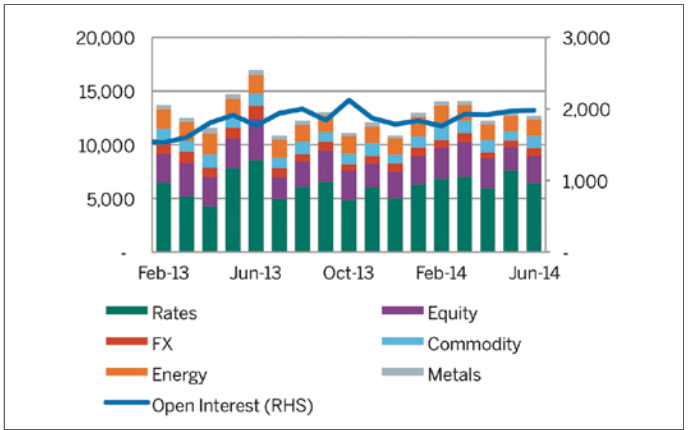
The Federal Open Market Committee (FOMC) holds eight scheduled meetings a year, and additional meetings as needed. FOMC meetings are closely watched all over the world, as the Fed funds rate is one of the most important leading indicators of which way the US economy is likely to go. If rates are raised, the market will expect slower growth in the economy in the near future.

Our Chief Economist Bluford Putnam recently explained the dynamic interactions between labor market conditions, economic growth and inflation expectations in his recent Market Insights report. Please refer to "The Yellen Fed and US Labour Market Dynamics" report dated 16 June 2014[1].

Chairperson Janet Yellen referred to recent inflation data as "noisy" and said that "recent evidence ... suggests we are moving back gradually over time to our 2% objective." Economic data reported following the FOMC meeting depicted a strengthening labor market, and improving manufacturing and housing sectors.

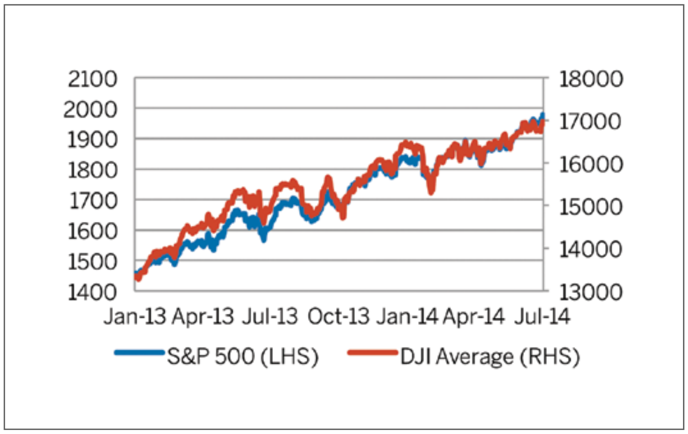
The FOMC announced another $10 billion tapering of its QE purchases. There were no changes to the medium-term policy guidance, and the FOMC minutes suggest that the QE program is not expected to wind down until at least Q4 2014 and the Fed is not expected to raise rates until 2015.

ADV & Open Interest (000 lots)



Source: CME market data as at 3 July 2014

S&P 500 and DJI Average



Source: CME market data as at 3 July 2014

[1] cmegroup.com/education/files/the-yellen-fed-and-us-labour-market-dynamics.pdf

Japan

Meanwhile, a year and a half into the Abenomics experiment, Japan's Prime Minister Shinzo Abe has found it difficult to deliver on his bold promises of economic growth. Policies have met with resistance due to demographics and cultural traditions.

"Abenomics" is a reference to the policies implemented in Japan under the direction of Mr. Abe, who assumed office in December 2012. Abe's ambitious plans were intended to address the economic malaise experienced in Japan since the late 1980s, after the Japanese real estate and equity "bubble" burst.

Our Managing Director of Financial Products, John Labuszewski, had discussed the possible effects of Abenomics in an article published in August 2013[2], and Blu updated the challenges Abe has faced since then, in a recent article published in May 2014[3].

Market reforms have been few and far between. The market is no longer expecting Japan's GDP growth to be robust in 2014. If Abe were to push for further depreciation of the yen to try to boost economic growth, it might have a positive impact on yen denominated equity prices. However, this might only happen if the market believes that Abenomics has put in place fundamental improvements in the Japanese macroeconomy for the longer term.

The Three Arrows of Abenomics

Fiscal Stimulus	Increase in government spending and public works investment in its 5-year plan (through FY15)
Monetary Easing	Aggressive inflation targeting at 2% through quantitative easing, correction of excessive yen appreciation
Structural Reforms	Regulatory reforms and revitalization of the industries to boost Japan's competitiveness

Source: CME market data as at 3 July 2014

China

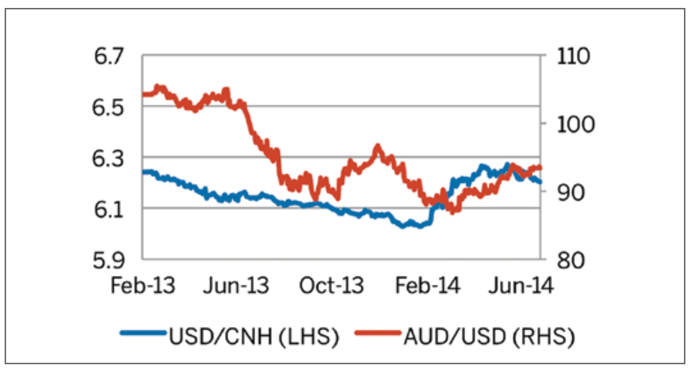
The Chinese central government has been delivering small doses of mini-stimulus measures in the past couple of months. These measures include more tax relief schemes, faster infrastructure project approvals, and reforms to promote the growth of SMEs, amongst others. Banking measures include maintaining adequate interbank liquidity, specific monetary and credit easing, and on-lending liquidity injection. In early June 2014, the Chinese cabinet carried out targeted cuts in reserve requirement ratios (RRR) for selective banks.

The purchasing managers' index (PMI) in China has shown improvement over the past few months, and reached a seven-month high of 50.7 for June.

Investors who wish to take a view on the Chinese financial measures might conceivably take a position on the USD/CNH. However, given that the RMB is soft-pegged to the USD, it may not fully reflect the macroeconomic conditions in China[4]. Market players also tend to take a longer term directional view on the RMB when investing in the CNH.

Alternatively, investors can take a position on China's commodities import or consumption outlook by investing in the AUD/USD futures traded on CME's platform. More on this in Currencies section.

CNH Trades in a Narrow Band



Source: CME market data as at 3 July 2014

[2] cmegroup.com/education/featured-reports/focus-on-abenomics.html

[3] cmegroup.com/education/featured-reports/challenges-to-abenomics.html

[4] NOTE: CNH may not a perfect proxy for the Chinese economic conditions. The CNY remains on a soft peg to the USD. The CNY is allowed to fluctuate within a 2% trading band, which makes it mildly responsive, but this may not be enough to be truly reflective of economic conditions. If the CNY bumps up against the limit, it could become locked for an extended period.

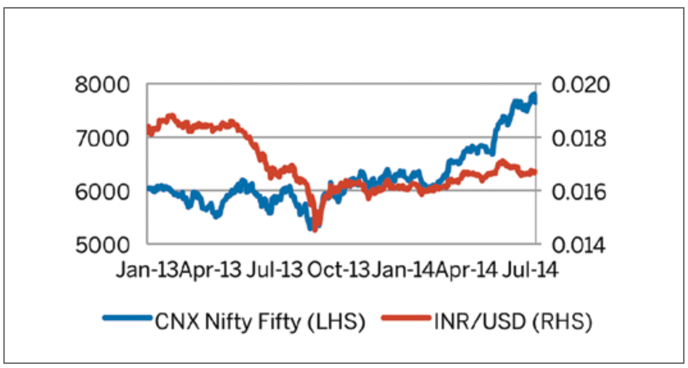
India

The BJP-led NDA coalition won the Indian general election by a wide margin, and the majority of seats in the lower house of parliament, in May 2014. Narendra Modi was sworn in as the Prime Minister, and has raised hopes that India can unlock its economic potential rapidly.

The Reserve Bank of India (RBI) has left the repo rate on hold, and reiterated its goal to bring CPE down to 8% by January 2015. RBI also cut the statutory liquidity ratio in its monetary policy.

The improvement in India's macroeconomy and the INR strength had partly been helped by the restrictions on gold imports. Whether the INR can maintain its uptrend will depend on how successful Prime Minister Modi carries out his reform plans. The market is also hoping that the new government will loosen its restrictions on commodity exports and gold imports in the near future.

INR Weakness Halted; Nifty Rose



Source: CME market data as at 3 July 2014

Middle East and Eastern Europe

The military situations in Iraq and Ukraine are significant political events which could affect the US and Asian financial markets. However, the impact on the US and Asian equities indices, FX and interest rates markets might be more of a sympathetic or reflexive price action than due to fundamentals.

As an alternative, investors are able to take an investment view on such events through the Commodities markets. For more information on CME Group's suite of benchmark commodities products, please contact cmeasiateam@cmegroup.com.

Can Invest Through Various CME Products

This is a quick bird's eye view of our core CME Group Financial Products. In a nutshell, CME Group has benchmark futures contracts across all the major asset classes through which investors can take a view on the changing market conditions.

- Equity Index Futures: The S&P 500 and Nikkei 225 futures offer direct exposures to the US and Japan equity markets, and these indices are good proxies to the macroeconomic conditions in the global and Asian regions.
- FX Futures: As an alternative to equities indices, currency futures also offer good exposures to macroeconomic conditions. The AUD FX futures are proxies to both the Chinese and Australian economies, as these two economies are closely linked by their commodities trades.
- Interest rate futures. Bond yields in both the US and Japan have remained low amidst the easy money policies in both countries, and investors can express their short term view through Eurodollar futures, and their longer term view through US Treasury bond futures.
- Gold futures are typically used as an inflation hedge. Changes in inflation and risk outlook tend to be reflected in gold prices.
- The contract specifications of CME Group's core financial products highlighted in this report are summarized at the end of the report.

Interest Rates and Bond Markets

Recall that 10 year Treasury bond prices were trading at highs of 130s during the first half of 2013, fueled by fears of a debt crisis in the US, a failure of the Euro, and of the Fed raising interest rates. The drop in the 10-year bonds to the 125 range since then possibly reflected the benign Fed rate guidance and monetary policies.

Nuances during Yellen's press conference after the June Fed decision suggested that there is no rush to raise rates. "The Fed will reduce the bond purchases by another $10 billion and reiterate that the rates will stay low for some time," she said.

The Fed seems to be willing to tolerate higher inflation in exchange for improvements in the labor market.

Nobody expects the Fed rates to stay low forever. If the Fed raises short term interest rates, two different scenarios could result[5].

If the Fed tightens credit market conditions in response to improving macro-economic conditions, but without core inflation rising above 2%, it might result in a flattening of the yield curve.

If improving labor market conditions prompt the Fed to raise short term interest rates, and inflation rises through 2%, toward 3% or higher, the market might think that the Fed is "behind the inflation curve". If so, it might result in an up-shift in yields across the entire term structure instead.

Eurodollar 3m-9m Spread

Source: CME market data as at 3 July 2014

Eurodollar Spreads for Fed Play

A popular way to take a view on the timing and pace of the Fed tapering is to trade the Eurodollar 3 month-9 month (ED3-ED9) spread. This spread instrument is very sensitive to changes, and expectations of changes, in short term interest (Fed Funds) rates. The spread had been widening during the run-up to the FOMC meeting on June 16.

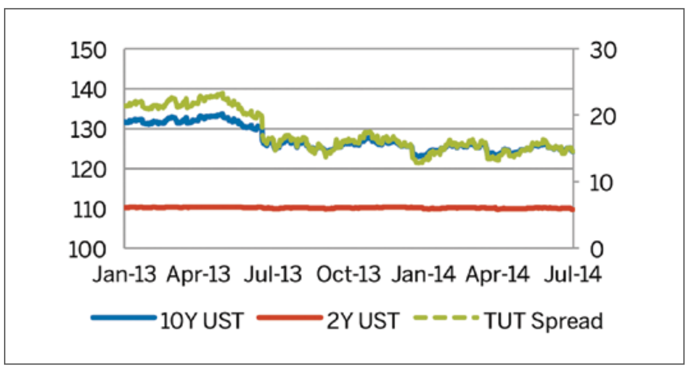
Now that the FOMC meeting is over, the market is again looking to the Eurodollar curve for guidance. The June 2015 Eurodollar futures appear to show some tightening, suggesting that the market thinks that the Fed might raise rates around June 2015.

TUT for a Yield Curve Exposure at the Long End

Investors may also want to take a view on the longer term fundamentals in the macroeconomic environment. This would be reflected in potential shifts in the slope of the Treasury Bond yield curve.

Trading the 10-under-2 (TUT) spread, using 10-Year and 2-Year Treasury Note futures contracts, is one practical way to take a position on changes in the shape of the longer term yield curve. Gains or losses on the spread will be the result of changes in the yield curve shape as opposed to changes in the direction of interest rates. TUT and ED spread trades done with CME futures receive margin credits, and may sometimes be a cost-effective means to capitalize on your yield curve outlook[6].

US T-Bond TUT spread



Source: CME market data as at 3 July 2014

[5] cmegroup.com/education/files/the-yellen-fed-and-us-labour-market-dynamics.pdf

[6] NOTE: The spread should be weighted relative to the volatility of 2- and 10-year T-note futures, so that the spread reflects the shape of the yield curve and not just the outright yield movements. A properly weighted spread qualifies for spread margin break

Currencies and Equity Indices

There were no significant changes to the Fed's policy guidance at the June FOMC meeting, other than a trimming of QE asset purchases by US$10 bn. The benign outcome of the FOMC meeting might keep FX volatility subdued over the short term, while breathing life back into the Emerging Markets carry trades. The market's initial reaction was a weakening of the USD and a strengthening of the Emerging Market (EM) currencies.

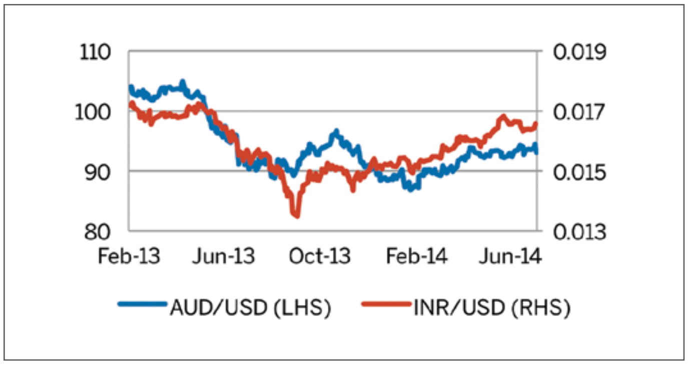
Some analysts believe that the Fed will gradually exit its QE program and start hiking rates by next year. As and when the Fed changes its view on inflation outlook, carry trades may become more risky and could start unwinding as the USD starts to rise against the EM currencies such as the CNH or INR, and commodity currencies such as the AUD.

Carry trade refers to the practice of borrowing lower-yielding currencies (e.g. USD) to fund bets in higher yielding currencies (e.g. CNH, INR, AUD). Carry trades became popular in the past because central banks in the EM economies were injecting liquidity into their markets, amidst low volatility in the global environment.

AUD as an alternative play on China

Besides carry trade, the AUD also offers investors an alternative exposure to China market (typically represented by the Shanghai Composite Index or Hang Seng index). The Australian dollar is sensitive to Chinese economic data because Australia is a major source of resource materials to China.

Stronger AUD, INR Help Carry Trade



Source: CME market data as at 3 July 2014

Taking a View on China FX Policy via CNH

Other than the RMB, Asian currencies have done relatively well against the USD in 2014, broadly due to the FX carry. Whereas central banks in Asia have been trying to reduce FX volatility, China's policy measures seem to be to inject more volatility into the RMB.

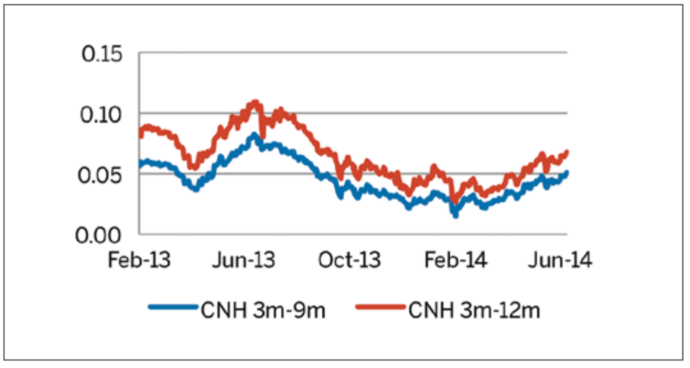
The PBOC appears to be sending a message to the market that it prefers to have the RMB trade with greater two-way flexibility. The RMB had appreciated steadily against the USD with little volatility in 2013, whereas it has been quite volatile in 2014. Some market analysts believe that the RMB's recent weakness, and the RMB fix trending lower, may be the result of PBOC's guidance, and that the trend may not be sustained.

Given the weakened state of the Chinese economy, the PBOC probably welcomes the current weakness of RMB. However, as a consequence of the weak RMB, we could see an increase in capital outflows if carry trades unwind. If so, pressures to depreciate the RMB might continue over the short term.

As such, while there are many investors who seem to be bullish that the RMB will appreciate, and are maintaining speculative long RMB positions, there seems to be an increasing demand for the USD at the longer end of the forward curve.

Investors expecting a potential shift in the shape of the CNH forward curve could invest in a USD/CNH 3 month-9 month spread, or a 3 month-12 month spread to take a position on their view.

USD/CNH Calendar Spread



Source: CME market data as at 3 July 2014

Taking a View on India Policy via INR

The INR has been strengthening since 4Q 2013, possibly in anticipation of the strong election victory by the BJP. The INR had exhibited strong volatility right up to the election results, but the excitement seems to have waned.

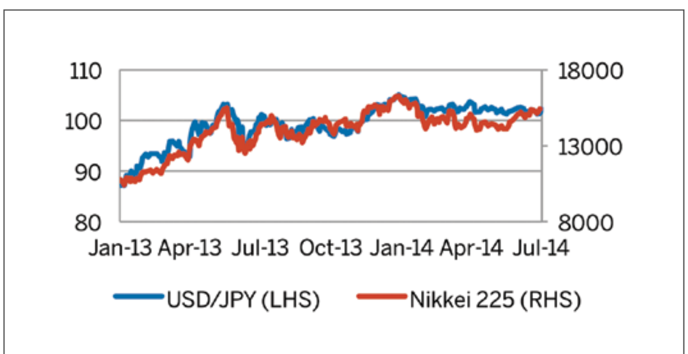
The CNX Nifty Fifty equity index has increased more than 15% since the election results. The market might possibly take the next cue from measures announced in the Indian Budget in July 2014.

Taking a View on Japan via JPY and Nikkei

When Abenomics was first announced in February 2013, there was an immediate impact on the Japanese yen (JPY), which retreated 30% from its highs recorded in February 2012. Japanese stocks, as measured by the Nikkei 225, rose to 75% above their lows from November 2011.

We are over a year into Abenomics, and the market seems disappointed in the economic growth achieved. Quantitative Easing (QE) has not led to significantly more bank lending. In fact, QE did not take place until commence about April 2013, after the yen had already moved. The actual implementation of QE has not led to further yen weakness since then. The market appears to be awaiting signs of a sustainable, longer term improvement in its macroeconomic fundamentals.

JPY and Nikkei 225 Tracking Sideways



Source: CME market data as at 3 July 2014

CME Group has Asian Currencies and Equities

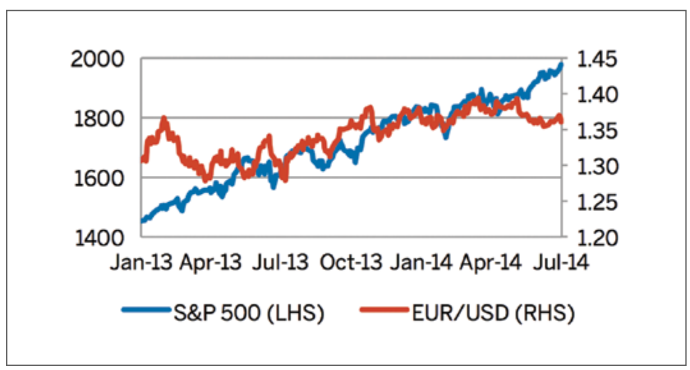
CME Group offers products that are directly and indirectly impacted by Abenomics and "Modi-nomics". Most obviously, these products include our JPY/USD, Nikkei 225 and INR/USD futures contracts. For investors seeking exposure to China's FX policy, we provide two CNH FX futures contracts and a Cleared OTC USD/CNY contract. Investors expecting market volatility in South Korea post the local elections and the unfortunate ferry accident can take hedge their risks via our KRW futures.

EUR/USD and S&P500 Also Relevant to Asia

The Asia markets obviously cannot ignore the potential impact events in Europe and the US has on the regional markets here. Ms. Yellen has given some guidance on the Fed policy at the recent FOMC meeting. The European parliamentary elections had taken place in May, and the ECB president Mario Draghi has recently cut its deposit rate below zero, in an effort to drive down the EUR and head off deflation.

Even if investors in Asia are not heavily invested in the US or EU markets, they may need to anticipate the potential impact such policies have on the Asian markets. CME Group's S&P 500 Index and EUR/USD futures contracts, our flagship contracts, provide investors with a very efficient means to take a broad investment view on the global financial markets.

EUR and S&P 500 Relevant to Asia



Source: CME market data as at 3 July 2014

Gold is Viewed as a Financial Product

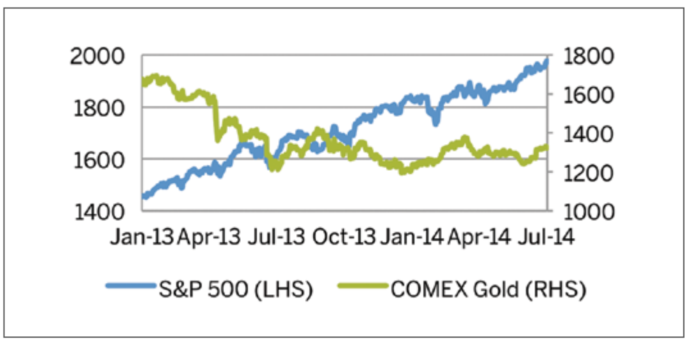
Gold is often seen as a safe haven against global uncertainties, and a hedge against inflation. As the Fed pumped stimuli into the economy, Gold prices have gained as interest rates were depressed, making alternative assets relatively attractive.

As and when the market anticipates the Fed to raise interest rates, or if Yellen makes unexpected comments about the path of monetary policy, investors could shift their investment weightages in gold.

There are over a dozen gold futures contracts in Asia. But most institutional investors in Asia trade COMEX Gold futures as the proxy for an exposure to Gold in Asia, due to its high liquidity.

Asia, in particular China and India, accounts for more than half of physical gold consumption every year. China imports accounted for almost the entire physical gold globally exported plus gold ETFs liquidated in the past three years. COMEX Gold futures will continue to play a prominent role in Asia's needs for hedging gold prices.

Gold an Inflation and Risk Hedge



Source: CME market data as at 3 July 2014

Impact of Secular Trends in US Labor Market

Coming back to the US market, which still dominates long term investment decisions in Asia, any structural changes in the US market are likely to have an impact on global markets.

As Blu emphasized in his recent analysis of the US labor market conditions[7] , one needs to consider both the level and rate of change of the macroeconomic indicators. Blu had explained the "standard" view which focuses on the absolute LEVEL of unemployment rate. And the "dynamic" view which emphasizes the PACE of the decline.

The current trend of a declining labor force could be interpreted as a secular, longer term correction if one takes the dynamic view. The 2008 financial crisis might have been the catalyst for the older or part-time workers to leave the labor force.

If this interpretation is correct, the long term full-employment labor force, and the size of the output gap might have been over-estimated.

Technological Innovations

Blu also noted that a structural slowdown or aging of the labor force is likely to spur technological innovations to boost labor productivity. One innovation already taking place is the discovery of new resources, such as the shale oil and gas evolution.

This evolution itself is posed to raise the potential real GDP in the US for at least another decade. We can probably expect more technology innovations to be developed in the future.

[7] cmegroup.com/education/files/the-yellen-fed-and-us-labour-market-dynamics.pdf

Exposure via Targeted Equities Indices

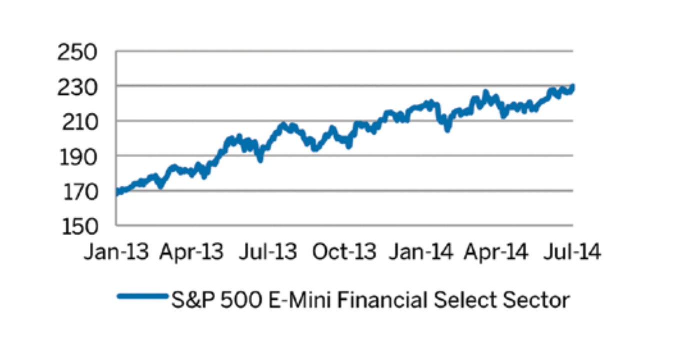
Many investors managing portfolios in Asia have taken a broad hedge to the US market through the S&P 500 Index futures and USD FX futures. The COMEX Gold futures is also used, as general hedge against inflation and political risks.

There may be investors in Asia who hold a view on specific market segments, such as the oil and gas, financial, consumer markets, etc. Such investors may be looking for futures contracts which are more targeted than the broad-based S&P 500, NASDAQ 100 or Dow-Jones Industrial Average index futures.

There are E-Mini futures contracts on several Sector indices which are also traded on the CME Group, all of which have good trading volume and open interest.

These include the E-Mini S&P Select Sector index futures on Financial, Energy, Consumer Staples, Consumer Discretionary, Utilities, Materials, Industrial, Health Care and Technology. There is also the broad-based Dow Jones-UBS Commodity Index futures. (Upon the expiration of its licensing agreement for the DJ-UBS, S&P Dow Jones recently launched a new DJCI index. The index futures contract which trades on the CME Group platform was renamed as the Bloomberg Commodity Index futures as at July 1, 2014.)

Targeted Exposure via Sector Indices



Source: CME market data as at 3 July 2014

Conclusion

The CME Group is a merger of five major futures exchanges, and offer futures and options contracts across the full range of products. The paper has discussed:

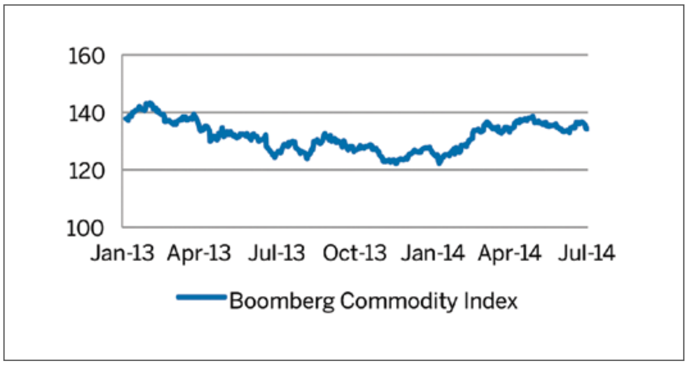
- CME equity indices such as S&P 500, Nikkei 225 and FX futures
- CBOT interest rate contracts such as the US Treasury futures and Eurodollars
- COMEX contracts such as Gold

The CME Group offers over 1,500 contracts, and the paper has not touched on many highly liquid products which are relevant to investors in Asia. Obvious candidates include DME Oman crude, Iron Ore, Deliverable Interest Rate Swaps, the Korean Won, Corn, just to name a few.

Where appropriate, trading strategies involving spreads were suggested, as well as outrights, as spread trades offer potential margin offset savings when both legs are traded on CME Group.

For more information on the products and incentive schemes available, please contact Malcolm Baker (Malcolm.Baker@cmegroup.com) for our financial products or cmeasiateam@cmegroup.com for general product enquiries.

DJ-UBS Commodity Index Renamed



Source: CME market data as at 3 July 2014

Highlighted CME Group Financial Products

Equity Index

E-Mini Standard & Poor's 500 Stock Price Index Futures	
Popular Name	E-Mini S&P 500
Contract Code	ES
Contract Unit	US Dollars per contract
Contract Size	$50 x S&P 500 Index
Price as at 10 July	1957.7
Average Daily Volume	1,657,000
Open Interest	2,937,000
Settlement	Financial

Nikkei Stock Average Futures Yen-denominated (or US Dollar denominated)*	
Popular Name	E-Mini S&P 500
Contract Code	ES
Contract Unit	US Dollars per contract
Contract Size	$50 x S&P 500 Index
Price as at 10 July	1957.7
Average Daily Volume	1,657,000
Open Interest	2,937,000
Settlement	Financial

* The USD-denominated contract size is $5 x Nikkei 225

Bloomberg Commodity Index Futures	
Popular Name	Dow Jones-UBS Index *
Contract Code	AW
Contract Unit	US Dollars per contract
Contract Size	$100 x Bloomberg Commodity Index
Price as at 10 July	131.2
Average Daily Volume	900
Open Interest	15,000
Settlement	Financial

* The name was changed effective from July 1, 2014

E-Mini Financial Select Sector Futures	
Popular Name	E-Mini Financial Select Sector
Contract Code	XAF
Contract Unit	US Dollars per contract
Contract Size	$250 x S&P Financial Select Sector Index
Price as at 10 July	225.7
Average Daily Volume	130
Open Interest	1,500
Settlement	Financial

Interest Rates

Three-Month Eurodollar Futures	
Popular Name	ED
Contract Code	GE
Contract Unit	US Dollars
Contract Size	Eurodollar interbank deposit $1 million principal value
Price as at 10 July	99.645
Average Daily Volume	2,474,000
Open Interest	11,620,000
Settlement	Financial

Long Term US Treasury Note Futures (6½ to 10 yr)	
Popular Name	10-year T-notes
Contract Code	ZN
Contract Unit	US Dollars
Contract Size	US Treasury-note face value $100,000
Price as at 10 July	125.172
Average Daily Volume	1,326,000
Open Interest	2,593,000
Settlement	Financial

Currencies & Gold

Euro Foreign Exchange Futures

Popular Name	EUR/USD
Contract Code	6E
Contract Unit	US Dollar per Euro
Contract Size	125,000 Euro
Price as at 10 July	1.361
Average Daily Volume	190,000
Open Interest	295,000
Settlement	Financial

Japanese Yen Futures

Popular Name	JPY/USD
Contract Code	6J
Contract Unit	US Dollar per Japanese Yen
Contract Size	12,500,000 Japanese Yen
Price as at 10 July	0.00988
Average Daily Volume	135,000
Open Interest	160,000
Settlement	Financial

Indian Rupee Futures

Popular Name	INR/USD
Contract Code	SIR
Contract Unit	US Dollars per Rupee
Contract Size	5,000,000 Indian Rupees
Price as at 10 July	0.165
Average Daily Volume	40
Open Interest	160
Settlement	Financial

Standard US Dollar/Offshore RMB (CNH) Futures

Popular Name	USD/CNH
Contract Code	CNY
Contract Unit	RMB per US Dollar
Contract Size	USD 100,000 (⋕ RMB 650,000)
Price as at 10 July	6.208
Average Daily Volume	40
Open Interest	570
Settlement	Financial

Australian Dollar Futures

Popular Name	AUD/USD
Contract Code	6A
Contract Unit	US Dollars per Australian Dollar
Contract Size	100,000 Australian Dollars
Price as at 10 July	0.935
Average Daily Volume	75,000
Open Interest	105,000
Settlement	Financial

Gold Futures

Popular Name	COMEX Gold
Contract Code	GC
Contract Unit	US Dollars per troy ounce
Contract Size	100 troy ounces
Price as at 10 July	1,339
Average Daily Volume	156,000
Open Interest	400,000
Settlement	Physical

ED133/00/0714