FUTURES IN FUNCTION OF RISK MANAGEMENT AND FINANCIAL MARKET DEVELOPMENT

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Abstract. Financial engineers are creating a great number of new financial instruments – financial derivatives that have purpose to better manage and decrease risk. The most important financial derivative is futures contract. Owners of futures contracts have initial right to buy some commodity or financial asset (currency, stock, bond, interest rate, market index etc.) in defined future time and at fixed price. The basic difference between commodity and financial futures is that financial futures in the most cases do not result with physical delivery of market instrument but only with payment of price difference. Futures contracts are very similar with forwards but they have improvements that have resolved some disadvantages of forwards like problems of default fulfilling obligations and illiquidity of market. In this paper, authors will show the significance of using futures in order to decrease risks, earn sizeable profits and influence on development and efficiency of financial market.
Key words: futures, risk, financial market.

INTRODUCTION

Derivative instruments initially emerged as hedging devices against fluctuations in interest rates and commodity prices. Financial derivatives have changed the face of finance by creating new ways to understand, measure, manage and decrease financial risks. Derivatives offer market participants to break financial risks into smaller components and then to best meet specific risk management objectives. Derivatives offer benefits such as risk management and efficiency in trading to its users. Using derivatives should be part of any risk management strategy to ensure enhancing investment opportunity value. Financial institutions have very important role on the financial derivatives market because they often use financial derivatives to decrease capital costs, manage risks and conduct arbitrage on the global financial market.

John C. Hull defined derivative as a financial instrument whose value derives from the value of other underlying variable (like security or some other asset). Financial derivatives have based on sales contracts that have delayed delivery and payment of market effects. Derivative instruments ordinarily include agreement between two parties about exchange specific asset or cash flow on predetermined price in future date. The value of derivatives depends on the value fluctuation of basic asset. Also, financial derivatives have as characteristics standardization of asset, rules of issuing, means of payment, delivery, maturity, rules of trading etc. (Dugalić, Štimac, 2007, p. 134). The most frequently used financial derivatives are futures contracts, options and swaps.

Futures as one of the most important derivatives bring three benefits to its users: 1) risk management, 2) trading efficiency and 3) speculation. Futures provide a powerful tool for limiting risks that individuals and organizations face in conducting business. Successful risk management with futures requires a thorough understanding of the principles that govern the pricing of financial derivatives. Used correctly, futures can save costs and increase returns. Futures allow free trading of individual risk components and thereby increase trading volume and improve financial market efficiency. Traders can use a position in one or more futures as a substitute for a position in the underlying instruments on spot market. In many instances, traders find futures to be a more attractive instrument than the underlying security. Reason being, the greater amount of liquidity in the financial market offered by the futures and lower transaction costs associated with futures trading as compared to the costs of trading the underlying instrument. In addition, futures can serve as a speculative tool. Futures act as a powerful instrument for educated traders to expose themselves to properly calculated and well-understood risk in pursuit of a profit.

Futures and other derivatives have also the other side. Companies like Procter & Gamble, Long Term Capital Management, Barings Bank etc. experienced huge losses from derivatives trading in the early 1990's.

Barings Bank lost around 1 billion dollars just because one trader whose job was to carry out low risk arbitrage switched from being an arbitrageur to a speculator. The hedge fund named Long Term Capital Management lost about 4 billion dollars in 1998. The treasury department of Procter & Gamble lost about 90 million dollars trading highly exotic interest rate derivative contracts. These losses warn the users against excessive use of financial derivatives. Without a clearly defined risk management strategy, excessive use of futures and other financial derivatives can cause serious losses and can threaten the investor's long-term goals. Hence, it is important that users of futures fully understand the complexity of financial derivative contracts and accompanying risks.

In recent years, the market for futures and other financial derivatives has grown tremendously in terms of variety of instruments available, their complexity and turnover. The main aim of this paper is to show the significance of using futures in order to decrease risks, earn sizeable profits, increase trading volume and efficiency of financial market. In addition, characteristics of futures, basic futures strategies like hedging, types of traders and forecast price techniques are going to be presented next.

CHARACTERISTICS OF THE FUTURES AS FINANCIAL DERIVATIVES

On The Chicago Board of Trade in 1975 were formed futures contracts to resolve problems of default risk and market illiquidity of the forward contracts. Futures contracts emerged with purpose to reduce risks of negative changes of prices, interest rates, currency exchanges and bourse indexes in specific future time. Futures are standardized contracts that have a-priori determined price so-called strike price, quantity, quality, maturity, place and conditions of delivery of the market instruments (commodity, stocks, bonds, market indexes, currencies, interest rates etc.) in defined future time (Vindžanović, Momčilović, Vlaović Begović, 2011, p. 310). Types of futures contracts by market asset are commodity futures (for example futures on grains and oilseeds, meat and livestock, metals and oil) and financial futures (for example interest rate futures, currency futures, futures on securities, futures on stock indexes etc.).

The difference between futures and classical term contract is in determination of exact date of delivery, because in futures contract is set a month of delivery and exchange determines standardized time in the month when parts should execute delivery and payment. Futures contracts are also similar to interest rate forward contracts because one part have obligation to deliver some financial instrument to other part in defined future time. However, futures are different of forwards in two segments. Firstly, futures have resolved problems of contract contempt with system of margin account that is every day accorded with market price movements. Exchanges established category of initial deposit on margin account that goes on between 5 to 10% of contract value to neutralize default risk in trading procedures with futures contracts. Before signing a contract investors have to deposit initial margin that can be in money and in securities like bonds. Investors must maintain a minimum margin level called maintenance margin. (Vindžanović, Momčilović, Vlaović Begović, 2011, p. 310).

Margin accounts are daily adjusting with market price of futures and every raise of prices compared to day before brings investor daily earning that accumulates on margin account and vice versa. If happens the case that after decline of prices investor have large daily lose and balance on margin account declines below minimal amount (75% of initial deposit value) investors have to make additional payment to the level of the initial margin that is called margin call. Investors have time until the end of next workday to fill the balance on margin account, and if they do not do so, broker has right to close the position with selling of the futures contract. If balance on margin account exceeds the level of initial margin, investor can cash the surplus funds.

Secondly, futures have standardized quantities and dates of delivery that raises chances to find interested parties and liquidity of market. The standardization of futures contracts affords tremendous flexibility because buyers can exchange one contract for another and offset their obligation to take delivery of the instrument underlying the futures contract. Offset in the futures market means taking another futures position opposite or equal to the initial futures transaction. With futures, investors often trade on organized exchanges like The Chicago Board of Trade, Chicago Mercantile Exchange, Kansas City Board of Trade, New York Futures Exchange, London International Financial Futures Exchange, Marche a Terme International de France, Deutsche Terminborse and Swiss Options and Financial Futures Exchange.

Every of the mentioned exchanges represent each other strong competition and tries to set some ground rules that are going to increase volume of futures transactions. Interesting characteristics of futures contracts that makes them differ than other securities is that investors could trade with futures contracts only on exchanges that issued them. In the beginning, USA term exchanges were dominating with futures trade but strong development of futures market and high revenues resulted with entrance of foreign exchanges that recognized chance of earning profit. Globex electronic trading system contributed further expanding and globalization of futures market because it allows futures contract trading even when exchanges are not officially open. In these way futures trading become international and competition between American and other exchanges will be even more intense in the future (Vindžanović, Momčilović, Vlaović Begović, 2011, p. 310).

Unlike forward contracts, futures have cash-settlement process of payment a difference between the strike price and the market price on the fixed future time, and not by the physical delivery and payment in full on the date. In most cases futures contract don't end with delivery of financial instrument on maturity because that can be avoided with another contract that can neutralize that position. Investors can open a long position and consequently, if conditions are right, open a short position that gives investor right to cancel both contracts. Futures traders charge one commission that is called commission in both ways, for opening and closing the position and it goes around 18% of transaction value. Characteristics of futures contracts is presented sublimed in the table 1 (Vunjak, Kovačević, 2009, p. 249).

Table 1: Characteristics of the futures contracts

1. All elements of futures contract are standardized (asset, quantity, quality, maturity and place of delivery);	6. In the most cases there is no physical delivery of contracted asset, but there is payment of difference in price;
2. Futures contracts are more liquid compared with forward contracts;	7. In the most cases contracts are neutralized before maturity;
3. There are payments in time that contract last (daily settlement) – margin system;	8. Contracted parts are obligated to give deposit on margin account to prevent credit risk;
4. Clearing house is guarantee of trading;	9. Futures contracts are sold at term;
5. Contracted position can be closed in every point;	10. Investors can trade with futures contracts on organized exchange.

Also, futures have significant advantages like leverage, liquidity, transparency and financial integrity. One of the key benefits of trading in the futures markets is that offers the trader financial leverage. Leverage is the ability of a trader to control large amounts of instruments with a comparatively small amount of capital. As such, leverage magnifies both gains and losses in the futures market. The benefit of leverage is available because of the margin concept. When you buy for example stock, the amount of money required is equal to the price of the stock. However, unlike trading a stock, a futures contract transaction requires both the buyer and seller to post a performance bond margin. A minimum margin requirement represents a very small percentage of a contracts total value. Because margins represent a very small portion of total market exposure, futures positions are considered highly leveraged. Such ability to trade contracts with large underlying values is one of the reasons why profits and losses in futures can be greater than trading the underlying cash contracts. This can be an attractive feature of futures trading because little capital is required to control large positions. At the same time, a bad trade can accrue losses very quickly. In fact, trader can lose more than his initial margin when trading with futures. This is why successful traders must develop a sound trading plan and exercise great discipline in their trading activities.

Another key benefit of futures trading is liquidity. Liquidity is a characteristic of a market to absorb large transactions without a substantial change in the price. Liquid markets easily match a buyer with a seller enabling traders to quickly transact at a fair price. Many futures markets are considered transparent because the order flow is open and fair. Everyone has an equal opportunity for the trade. With the advent of electronic trading, transparency has reached new heights as all transactions can be viewed online in real time. Transparency makes all market participants equal in terms of market access.

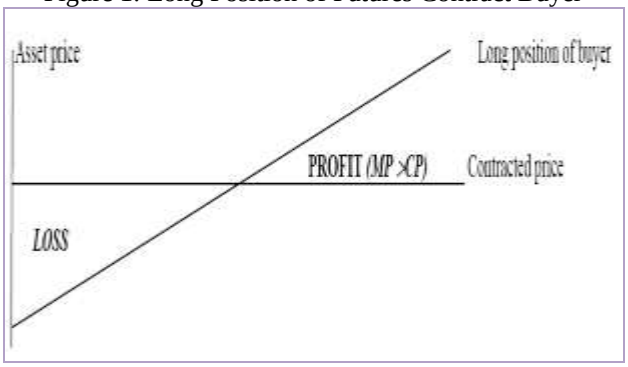
Futures markets give investors confidence through a clearing service system that guarantees the integrity of trades. Clearing service providers, in conjunction with their clearing member firms, created a two-tiered guarantee system to protect the integrity of futures and options markets. One tier of the system is that the clearing service provider acts as the counterparty to futures and options trades. The other tier is that clearing firms extend their own guarantee to buyers and sellers who are not clearing firms. All firms and individuals who do not hold memberships or ownership interests in the clearinghouse must clear their trades through a clearing firm, which then guarantees these trades to the clearinghouse. This allows all market participants to rest easier because clearing firms will protect trades they guarantee, even if the original counterparty defaults (Internet source: www.efutures.com/documents/CBOT_49710.pdf, p. 3 - 5).

FUTURES STRATEGIES AND TYPES OF TRADERS

Futures strategy depends on the position which investor has in regards of owning an asset. There are two futures positions that investors can open: a short and a long position. Short position represents position of seller of futures contract, where he has the obligation to deliver contracted asset in time of maturity and receive payment from buyer. Long position is position of buyer of futures contract, where he has the obligation to take the contracted asset and place payment in the time of maturity. When investor owns some asset and wants to avoid a possible risk of declining prices, investors chooses to open a short selling position. In reverse case, if investor doesn't have in possession asset he opens a long buying position. This strategy is called hedging. The goal is to decrease risk and cancel loses in trading on the one side with gains on the other side (Vindžanović, Momčilović, Vlaović Begović, 2011, p. 311).

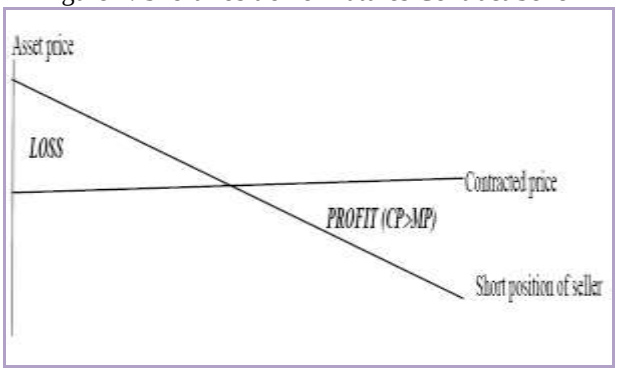
Buyer of futures contract is in long position and in his interest is that asset prices after signing futures contract start to raise, because it will create profit that is equivalent to difference between higher market price (MP) and lower contracted futures price (CP). Buyers profit is going to be bigger if the asset prices have sizeable growth that creates positive price difference. A position of the futures contract buyer is shown on figure 1 (Vunjak, Kovačević, 2009, p. 228).

Figure 1: Long Position of Futures Contract Buyer



Futures contract seller is in better position if asset prices after signing futures contract starts to fall because he can sell asset, for example security, at higher price and on that way earn profit. Profit amount depends on amount of market prices decline and it is equivalent to difference between higher contracted futures price (CP) and lower market price (MP). Position of futures contract seller is opposite on futures contract buyer. A position of the futures contract seller is shown on figure 2 (Vunjak, Kovačević, 2009, p. 229).

Figure 2: Short Position of Futures Contract Seller



Special interest to successfully predict futures price has buyer, because on this way he has possibility to fully exploit hedging and speculative advantage that arise from use of financial derivatives. Futures prices are regularly publishing in financial reports and press statements. Futures prices are forming on exchange floor on the base of futures contracts supply and demand. If there are more investors that want to buy futures contracts and open a long position than investors that want to sell futures contract and open a short position, then prices of market asset raises, in reverse case they fall. Equilibrium futures price can be calculated with this formula (Vunjak, Kovačević, 2009, p. 229)

FP = SP * (1+ SIR – YR).

Where FP is futures price, SP is securities price, SIR is short-term interest rate on principal until the maturity of futures and YR is yield rate on securities until the maturity of futures. Futures price depends on numerous factors: price changes of basic asset, weather and political occurrences, economic predictions, speculative behavior on exchanges, inflation, expectations, budget deficit, macroeconomic policy etc. For example, situation of bad weather can cause raise of commodity futures prices or rumors on exchange regarding to surprising raise of government bonds demand can cause direct raise of their prices and reverse. Futures prices can fluctuate in daily limits specified by the exchange to eliminate potential speculative behavior on futures exchanges and every break of limit has for consequence the suspension of further trade with specific futures contract.

Traders play a vital role in the futures markets by providing liquidity. On the futures exchanges there are the two most common participants: hedgers and speculators. Hedgers are participant who trades with specific asset and they are often manufacturers of specific commodity who sells futures contracts to protect themselves from price risk. Hedgers on financial futures market are managers of pension and investment funds, investment banks and insurance companies. Hedgers enter in futures transactions to ensure their future position on spot market. The greatest risk that hedgers face is basis risk. Basis risk is difference between spot prices of asset that is object of hedging and futures price (risk premium). Basis risk is close to zero when the maturity of futures contract is near. If asset prices raises faster than futures prices, then basis risk raises and other way around (Vindžanović, Momčilović, Vlaović Begović, 2011, p. 312).

Optimal hedging coefficient is product of correlation coefficient between spot price and change of futures price and fraction of standard deviation of spot price and standard deviation of futures price. The amount of profit and loss in hedging transactions depends on connection between spot price and futures price in time of signing and maturity of hedging. In hedging traders opens long buying position and short selling position. At hedging of short selling position, in situation of buying government bonds (long position) investor should execute selling (short position) to ensure protection from changes in prices of futures contracts until the maturity. If after signing futures contracts to sell and buy, price of futures falls, then investor is going to earn profit, because he sold futures contract at higher price then the current market price of futures contract. Investor is next going to enter in new buying position of futures at current lower market price and in the same time execute selling of specific future contract. In this way investor, completely neutralize loss that would occur with fall of market value of bonds that are in his hands. At hedging of long buying position, in situation of term selling investor don't wait a few days until the maturity to buy contracted asset, but he do so right now with opening a long buying position in futures contract at current market price. If asset price rises

until the maturity, then investor opens short selling position at higher market price and earns profit on difference between buying price (long position) and selling price (short position).

Although, futures are designed primarily to assist hedgers in managing their exposure to price risk, the liquidity of market would not be possible without the participation of traders or speculators. Speculators provide market liquidity, which allows the hedgers to enter and exit the financial market in more efficient manner. Speculators are constantly trading with futures contracts in order to earn profit and they set their position on assessment of possible occurrences with specific asset prices. If speculators assess that price of specific commodity or security is going to change, then they accordingly open a long or short position. Speculators buys when they assess that prices are lowest and sells when they assess that prices are highest. Speculators accept investment risks and expect a large profit from opportunity in price changes. Speculators frequently open long and short positions in futures contract trading that result gains and losses on futures accounts, with ultimate goal to earn net profits in futures trading during the year. Thanks to speculators, trading on futures exchanges is very active. If hedgers would be only traders on the market, buying and selling accounts would pair very slowly. With speculators as participant on futures exchanges reactions on spot market changes are very fast. Also, traders do not use only spot or future market for trading but combination of both that result with increasing trading volume and development of financial market. (Vindžanović, Momčilović, Vlaović Begović, 2011, p. 313).

Futures traders can be categorized in a number of other ways. There are full-time professional traders and part-time traders, traders who trade on the trading floor or behind a computer screen, public and local traders, proprietary traders, market traders, scalpers, day traders and position traders. Each of these market participants plays an important role in making the financial market more efficient. The vast majority of speculators are individuals trading off the floor with private funds. These diverse groups are generally referred as "retail" business. With the growing movement from trading on the floor to the computer screen, the retail investor is becoming a more important force in futures trading. But the most visible speculator is the professional floor trader, or local, trading for his own account on the floor of an exchange. Locals frequently began their careers as runners, clerks or assistants to other traders and brokers. Locals are usually more interested in the market activity in the trading pit as opposed to the market activity in the underlying market instruments. With the growing popularity of electronic trading, local traders are often oriented to the electronic trade. The electronic local traders use the same methods as the locals except they do so through the Internet and a computer rather than in the trading pits.

Another major category of trader is the proprietary trader, who works off the floor for a professional trading firm. These "upstairs" traders are employees of large investment firms, commercial banks and trading houses typically located in major financial centers. This group has a number of different trading objectives. Some engages in speculative trading activity, profiting when the market moves in expected direction. Such proprietary traders are compensated according to the profits they generate. Other proprietary traders manage risk and hedge between different markets, both cash and futures, in order to exploit risk of price fluctuation or momentary inefficiencies in market-to-market pricing.

Market makers give liquidity to the market, constantly providing both, a bid and an offer. Increasingly important in electronic markets, market makers ensure that traders of all kinds can buy and sell whenever they want. Market makers often profit from the "spread," or the small difference between the bid and ask prices. Each of the traders types previously described uses a different strategy to achieve their goals. A scalper trades in and out of the market many times during the day, hoping to make a small profit on a heavy volume of trades. Scalpers attempt to buy at the bid price and sell at the ask price, offsetting their trades within seconds of making the original trade. Scalpers rarely hold a position overnight and often don't trade or make predictions on the future direction of the market. Locals and market makers often employ a scalping strategy, which is the most common source of market liquidity.

A day traders are similar to a scalpers in that they also typically do not hold positions overnight and are an active traders during the trading day. Day traders trade both off and on the floor. A day trader makes fewer trades than a scalper, generally holds his positions for a longer period than a scalper, and trades based on a prediction on the future direction of the market. Proprietary traders, locals and public traders are often day traders. A position trader might make one trading decision and then hold that position for days, weeks or

months. Position traders are less concerned with minor fluctuations and are more focused on long-term trends and market forces. Public traders and proprietary traders are often position traders.

Once investor decides to trade futures, he has to determine a strategy and determine how he wants trades to be executed. If investor is new to the market, it's important to get professional assistance and information about the various trading strategies and trade execution methods. Professional assistance can come in the form of a full-service broker providing market and trading advice. Some full-service brokers provide advisory newsletters to give a sense of how the market operates, and provide more specific advice and trade recommendations. Another trading alternative is to invest in a managed futures fund, where invested money will be pooled together with the money of other investors. With this increasingly popular method, a professional fund manager makes trading decisions with the pool of funds. Most major brokerage houses offer managed accounts, as do a numerous independent fund operators. Before making a decision in which fund to invest, investor has to research the fund's historical performance and the manager's trading style (Internet source: www.efutures.com/documents/CBOT_49710.pdf, p. 5 - 7).

Financial institutions often use futures contract to protect themselves form risk of interest rate change on micro and macro level with micro and macro hedging. Micro hedging represents use of specific futures contract for protection of specific asset or liability risk. For example when managers of financial institutions wants to protect the value of bond portfolio from increase in interest rates or when financial institution wants to fixate loaning costs to protect from possible increase in short-term interest rates they open a short selling position in futures contract.
Macro hedging is different from micro hedging because manager of financial institution do not use specific futures and other derivative contracts to protect specific asset and liability from individual risks but macro hedging looks the big picture, takes in consideration entire portfolio, and allows mutual settlement of the interest rate sensitivity of assets and liabilities. As result, there are many different aggregate futures positions and financial institutions do not exclude settlement and effect of total portfolio.

In ideal case, financial institution would like to decrease exposure to risks on the lowest level with buying and selling enough futures to cover total exposure to risks on entire balance, but with decreasing risk, expected profit is decreasing also, and financial managers rarely choose this option. Instead of choosing a completely protected position, many financial managers choose to undertake specific risk like interest rate risk, credit and currency risk and set selective protection through futures contracts. Completely protected position remains one of the options but decision depends from expectations of interest rate changes, objectives of financial institution and sensibility on profit and risk protection trade-off (Vindžanović, Momčilović, Vlaović Begović, 2011, p. 314).

FORECAST TECHNIQUES FOR PRICE MOVEMENT

There are two basic methods traders use to forecast future price movement: fundamental analysis and technical analysis. If investors could predict the right direction of prices with perfect accuracy, they would have no trouble making a fortune in the futures markets. However, an alternative would be to learn the forecasting techniques used by successful traders. Fundamental analysis applies to all markets including agricultural, financial, equity and metals. Fundamental trade centers upon the release of key government reports. If these official reports are in line with the market's expectations, the impact on market prices will be minimal. When actual figures vary from expectations, market prices can respond dramatically. Days on which key reports are released can present real trading opportunities due to the resulting dramatic swings in price. To take advantage of these opportunities, you must understand the meaning and potential impact of the report, as well as the market's prior expectations.

Some exchanges, like the Chicago Board Of Trade, provide intraday market commentary, which usually includes information from the reports and the impact on the markets. It's also important to keep in mind that price volatility is usually higher on release dates. Even if investors don't intend to trade based on a given number, they may find the value of any open positions changing significantly on these days. In any event, it's important to understand the impact of the major reports and other critical events, regardless of whether or not investors intend to trade on fundamental information. Like any trading method, fundamental analysis has its limitations. New data is always filtering through the markets and creating price changes. Opportunities

can come and go before investors even have a chance to react and while one piece of information may point clearly in one price direction, other factors can combine to drive prices in the other way. Forecasting futures prices is clearly tricky business and all traders face the same set of challenges. It's probably best to concentrate at first on only one or two related futures markets. Since so many factors can influence prices, limiting efforts in this way will make fundamental analysis a much more manageable task. Whether investor chooses to focus on agricultural or financial futures markets, a good understanding of fundamental price information will surely improve trading success.

Fundamental analysis is just one technique and traders often use technical analysis. Some traders uses only technical analysis to make trading decisions, while others use some combination of fundamental and technical analysis to determine if they want to be long or short and to time their trades. The technical analysis focuses purely on market information, primarily price movements, but also volume and open interest figures. The pure technical analyst works on the assumption that all fundamental information is already reflected in the price, and that it is more important to study the market's price behavior. Unlike the fundamental analyst, the market technician is not concerned with understanding the underlying fundamental news surrounding why the market moved. Rather, the technician attempts to predict future price direction by looking at previous patterns of price behavior. Charts, tables and graphs are the major tools of the technical analyst. Traders can organize and analyze market data in any number of ways depending on their preference. Traders use charts to identify price trends, special patterns or formations, and areas of support and resistance. The study of technical indicators is quite extensive and certainly has much more detail than authors can provide here. However, it should be kept in mind that while a sequence of price movements often indicates the likelihood of future direction, exceptions to these patterns can always occur. The best traders understand how to appropriately interpret these "chart patterns" and often have in mind a back-up plan if the market moves in unanticipated direction.

Moving averages provides another tool for tracking price trends. In its simplest form, a moving average is an average of prices calculated over a given period of time. For example, a 10-day moving average takes the last 10 closing prices, adds them up, and divides by 10. On the next day, the oldest price is dropped, the newest price is added, and these 10 prices are divided by 10 to obtain the average. In this manner, the average "moves" each day. Moving averages can provide the technician clues to the relative strength or weakness of a given market. Some moving averages are also viewed as support and resistance points. In this sense, moving averages provide opportunities for the trader to enter and exit the market. Moving averages are said to take the "noise" out of the price movement. This is due to the smoothing effect of a moving average. The sensitivity of the moving average relates directly to the length of time chosen for the average. For instance, a 5-day moving average will be more sensitive and will potentially prompt more buy and sell signals than a 20-day moving average. If the average is too sensitive, investors may find themselves jumping in and out of the market too often, paying excessive transaction costs. But if the moving average is not sensitive enough, investors may miss opportunities by identifying buy and sell signals too late. Moving averages can be used in any number of ways, and traders usually develop their personal favorites. Besides selecting the length of time for a moving average, types of prices used could also be altered. While closing prices are most common, some traders use an average of the high, low and closing prices. Some traders run two moving averages, one of high prices and another of the low prices, effectively creating a channel of prices. Moving average, unlike a chart formation, is not a forward-looking indicator. Rather, it follows the market and identifies only established trending patterns (Internet source: www.efutures.com/documents/CBOT_49710.pdf, p. 17-18).

While the primary focus of the technician tends to concentrate on price information, additional insight into the market can be gained by adding the dimensions of volume and open interest. The volume is the total number of long or short positions. Open interest, on the other hand, refers to the number of futures positions that have not been closed out either through offset or delivery. Open interest are futures contracts that remain open or unliquidated at the close of each trading session. Volume and open interest are considered confirming indicators, providing clues about how much strength is behind a trend. For example, if volume and open interest increase with prices, it is considered a healthy sign of a solid bull market. If prices fall momentarily, and volume declines as well, the bull market is probably not in jeopardy since this may reflect only a small sell-off.

Generally, strong volume and increasing open interest support a price trend, regardless of its direction. At the same time, this scenario is more likely to occur in a bull market since many public speculators are more naturally inclined to buy into a rally than to sell into a bear market. When looking at open interest trends, it's also important to keep a couple of other points in mind. First of all, many of the physical commodity markets (such as grains) have historical open interest patterns, or seasonality factors. For this reason, changes in open interest should be considered in relative terms. Secondly, many futures contracts will show a sharp drop in open interest as a delivery month approaches expiration. By looking at the behavior of open interest during past delivery months, you can judge better whether a current open interest trend is stronger or weaker than past patterns.

The technical analysis methods introduced here barely scratch the surface of technical trading systems. Numerous other methods have been developed. Many proprietary trading systems are also available as software programs or online services. When comparing technical to fundamental analysis, there are advantages and disadvantages. The primary advantage of technical analysis is that investors can follow several markets much more easily than when using a fundamental approach. One disadvantage of technical trading is that many other traders are looking at the same signals and searching the right opportunity. As a result, when a distinct chart pattern does develop, many orders may be sitting under the market waiting for the same trigger price. It is important to keep this in mind and to carefully make decisions about what types of orders to use and how. Since both technical and fundamental analysis have their strengths and weaknesses, it is unusual to find traders who use one exclusively. Many will follow fundamentals to get a broader picture of the market, while using technical analysis to fine-tune their strategy and select entry and exit points. Regardless of whether investors prefer a fundamental or technical approach to making trading decisions, investor's ultimate success will depend largely on ability to develop good trading habits.

CONCLUSIONS

In order to reduce the growing risks of interest rate and price changes on financial markets, financial engineers created derivative instruments like futures. Futures are instruments that derived from specific assets like commodity, securities, currencies, interest rates and exchange indexes. Futures in their essence represent contracts with term clausal for delayed delivery and payment of contracted asset. Futures contracts neutralized problems of poor liquidity and default risk of forward contracts.

Futures with time evolved and they have individual market life as sign of value, they become specific object of trade and the original asset only remains starting point that indirectly affects instruments value at maturity. Futures prices stays connected to changes of supply and demand of basic asset and exchanges keeps necessarily function of control. In the most cases in time of maturity, contracted asset is not going to be delivered and there is only payment of price difference. Futures have the two most important functions: 1) increases profitability of investment and 2) function of preservation the capital value, because futures are used as risk management instruments. In addition, futures have significant advantages like leverage, liquidity, transparency and financial integrity that influence on trading volume and development of financial markets.

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