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eurex

Euribor Spread Call for Aggressive Market Making on Eurex

The introduction of fully integrated Euribor calendar spreads on Eurex in June seen as the start of a range of new opportunities at least by those trading houses who dedicate a great amount of time to short term interest rates futures. However, so far volumes have not increased significantly and the main trading arena continues to be on other exchanges. The purpose of this short article is to outline the significance of introducing Euribor calendar spreads on Eurex and how it would benefit everyone involved in this very exciting market if traders would make use of the recent introduction of these spreads.

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By Ahmed Hamdi, CFA, Trafalgar Financial Futures, Gibraltar

There are three types of players in the Euribor market:

Firstly there are the big banks that find the Euribor market exceptionally appealing for gap management and for hedging swaps and caps. A big reason for this appeal is the offset of longs and shorts that is available in the futures market but not in the forward deposit market. As a result banks can manage their interest rate exposure to their hearts content without bloating their balance sheets or using up credit lines with their bank trading partners. The orders put in the market by the big banks are not usually price sensitive and it is not unusual for these orders to be very big and to be executed at market.

Secondly there are the market makers that will provide a two-way price and create liquidity for other players in the market. For market maker support there are sophisticated computerized market making systems available that will generate prices around a mid-price calculated by some means. Finally there are the "locals" who are very price sensitive and try to be long on the bid and short on the offer. Locals are essential to any market because they put aggressive prices that tighten the market and create extra liquidity and volume. Market makers must arrive first when an exchange introduces a new product as without them there will be no prices at which the big banks can trade. Once paper arrives from the big banks, the locals' arrival will be inevitable. The logical thing therefore is to encourage market makers to make two-way prices as a first step in creating volume for the Euribor contracts on Eurex. There have been many market making schemes promoted by Eurex since the Euribor contracts were first listed on the exchange. Although additional users were attracted none of these schemes could achieve a lasting shift of volume into Eurex.

With the introduction of the integrated spread trading at the end of June the vulnerability of market makers – one reason for the less aggressive quoting behaviour of some market makers in the past – was reduced.

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Spread markets by their nature are less volatile than the underlying markets (with back months spreads having even lower volatility than front months spreads). This allows the market maker to make markets in the front month and as long as one could peg the spreads then the system would automatically generate prices down the rest of the months. Admittedly, the spreads will be wider as one goes further into the future. However, by creative use of spread combinations one could tighten up these markets leaning on size in these spreads.

For example:
If the market in Sep-00 Euribor futures is **95.135 – 95.140** and the Sep-00/Dec-00 spread market is **0.325 – 0.33** then the system will spit out **94.805 – 94.815** as a market for Dec-00.

Besides the introduction of fully integrated spread trading the availability of more complex and sophisticated software that can interact with the exchange's API and can create fast and reliable markets especially with Eurex's new Windows front end make the markets in Euribor futures on Eurex more attractive. In other words there are additional new arguments in favour of making markets on Eurex in sufficient enough size and as tight as at other exchanges so that the big banks especially those in Europe would find enough reasons to execute their market orders on Eurex.

There is no reason why market making, providing one has the proper tools, should not be done aggressively. Thus market makers should seek to be the best bid and the best offer. They should seek to trade. Being long on the bid and short on the offer is an enormous advantage to have especially if one is leaning on size elsewhere.

The bottom line is that competition between exchanges is good from a trader's point of view. Competition means lower costs as exchanges try to lure more trading to their own platforms (trading on Eurex only costs a fraction of the exchange fees on other exchanges). It also means fairer pricing and less market manipulation. When one puts all that with the prospect of the Chicago Board of Trade products being available on Eurex within the year then it becomes clear that it is for the benefit of everyone if the market making efforts on the Euribor contract took a step forward. Now better tools than ever exist to do so.

Promising Start for NEMAX® 50 Options and Futures

On June 19, trading in options and futures on the NEMAX® 50 index was introduced at Eurex, allowing us trading participants to hedge via Eurex our various Neuer Markt positions existing in relation to the cash and OTC market respectively to trade the Neuer Markt on the derivatives side accordingly.

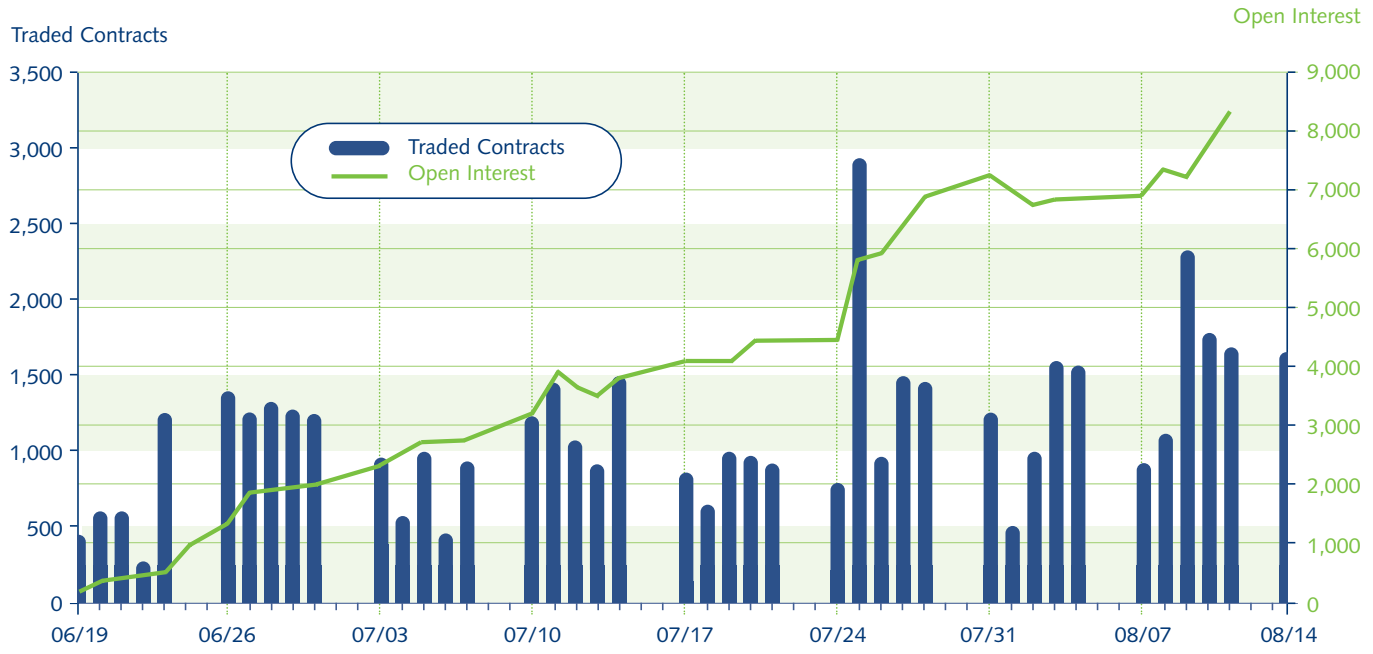
By Murat Baygeldi, Nomura International, London

The fact that professional and retail investors have more and more taken advantage of this opportunity can be seen from the continuously rising trading volumes. With initially 650 daily traded futures contracts and 220 options contracts, the numbers have meanwhile increased two-and-a-half-fold to 1,600 in terms of futures and ten-fold to 2,300 as far as options are concerned. Open interest, which serves, among other things, as an indicator for prospective volumes, has also risen on a constant basis, in the meantime having exceeded the number of 25,000 options contracts.

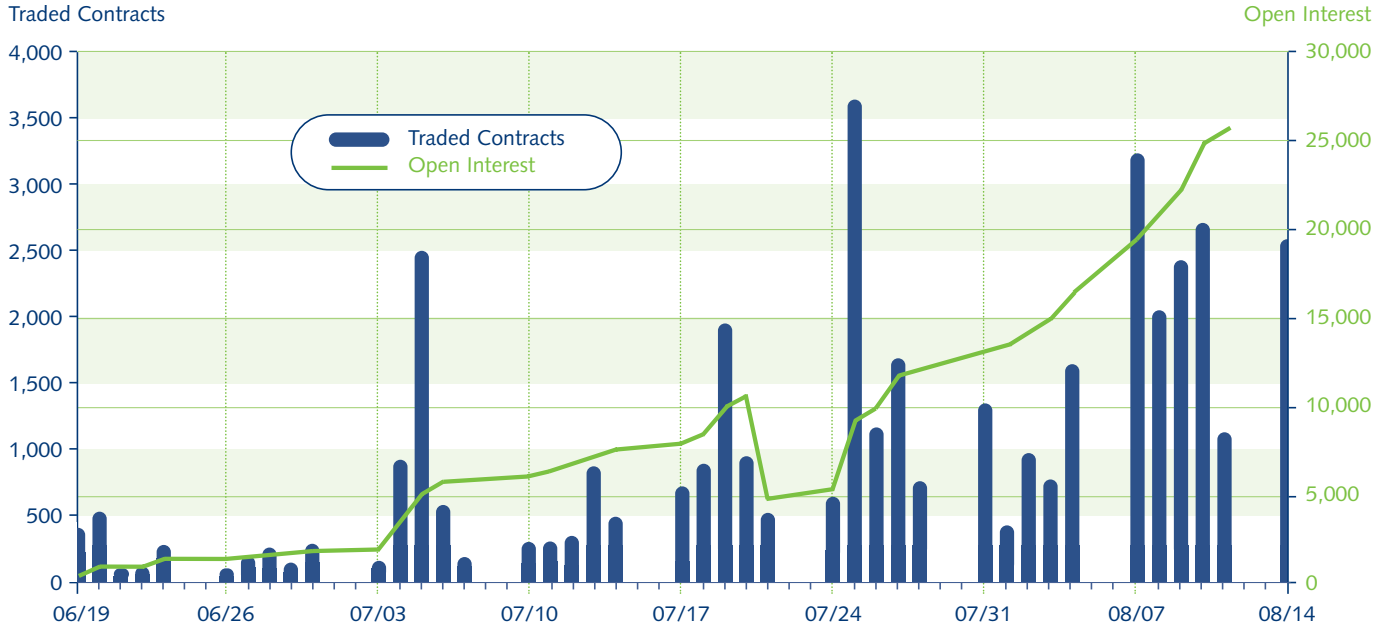
Certainly, one of the contributing factors has been a tightening of spreads recently – in the front month of the NEMAX® 50 future and in ATM options meanwhile coming to less than 10 points and

approx. 15 points on average, respectively. Thanks to the reliable and successful Eurex market making concept, we are able to guarantee our clients the execution of orders at market prices any time even with regard to these products. It should be stressed that this development is taking place against the background of rather stagnating and partly even receding volumes due to the currently somewhat thinner trading which involves lower volatilities. This is to be seen as a very positive signal – with the first futures contracts maturing in September, trading volumes are suggested to increase further and open interest to grow accordingly.

Trading Volume and Open Interest Development of the NEMAX® 50 Futures, June – August 2000



Trading Volume and Open Interest Development of the NEMAX® 50 Options, June – August 2000



Eurex Bonds: a New Platform for German Government Bonds Wholesale Trading

In the beginning of the year, Eurex Bonds was launched as a joint initiative of leading international financial institutions and Eurex Frankfurt AG. For this purpose, Eurex Bonds GmbH was founded as a full subsidiary of Eurex Frankfurt AG in the second quarter of 2000. With the start of Eurex Bonds beginning October 2000, however, 30% of the equity shares will be transferred to the joint venture companies.

Having been designed as an Electronic Communication Network (ECN), Eurex Bonds provides an electronic platform for the wholesale trading of German government bonds. Moreover, with the direct link of the Eurex Bonds trading platform to the clearing system of Eurex Clearing AG, the cash and derivatives market will be directly connected for the first time. This creates an electronic trading mechanism for the cash/futures basis, using a central quote book. Thanks to Designated Market Makers actively providing quotes, the necessary liquidity will be given in both bond and basis trading. In order to guarantee market making in its highest quality, the respective Designated Market Maker has to meet stringent requirements in terms of capitalization and experience in government bond trading.

Apart from Designated Market Makers which are to provide liquidity within the scope of defined quotation obligations, the admission of additional market participants bearing the status of "Liquidity Takers" is intended as of the end of October. They will be given the opportunity to participate in the trading process by entering buy and sell orders with the corresponding execution restrictions, i.e. "fill-or-kill" and "immediate-or-cancel". Market depth information is being made available to all market participants in a way that is known from the Eurex system.
Up to and until the introduction of the Integrated Clearer Functionality scheduled for the end of October, all transactions in cash bonds will be settled bilaterally between the various institutions involved. In this context, participants may choose between the two settlement institutions Clearstream Banking and Euroclear.

The various futures positions arising from basis trades will be recorded on the corresponding futures position accounts held by the participants with Eurex Clearing AG and may be netted against futures positions which were created at Eurex.
After the introduction of the Integrated Clearer Functionality, Eurex Clearing AG will also undertake clearing activities for all cash transactions concluded on Eurex Bonds in addition to the current futures clearing business. Again, the aforementioned settlement institutions will be supported accordingly.

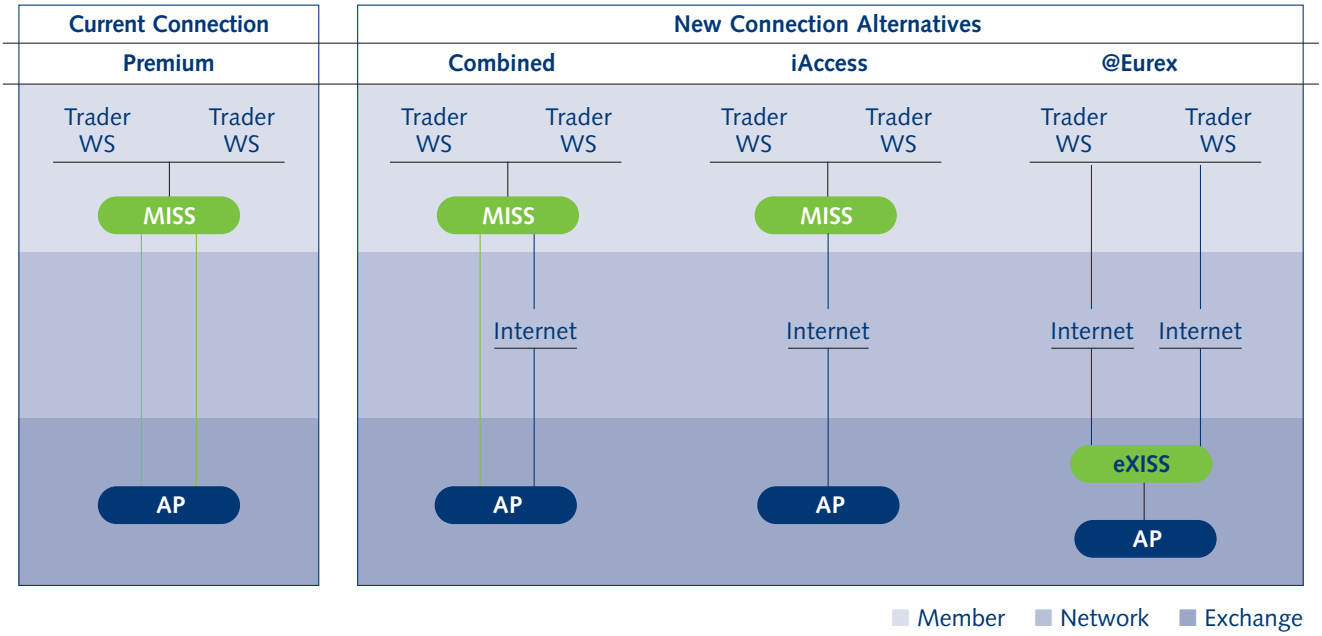
Deutsche Bundesbank, the German central bank, has already declared its intention of performing in future open market operations in debt instruments issued by the German Federal Government via Eurex Bonds.

Participation in Eurex Bonds requires the technical connection to the Xetra platform as well as an active Eurex membership.

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New Eurex Connection Alternatives

In an effort to offer its members the most appropriate connection scheme according to their specific trading volumes and expectations in terms of service, Eurex plans to introduce new connection alternatives. The following chart outlines the envisioned methods of connection, which will be launched by the end of the year:



The current "Premium" connection consists of two dedicated lines from the member's installation (MISS/UD) to an Access Point. This remains an option for high-volume members who want the security of the duplicate lines.

The "Combined" connection consists of one dedicated line and an alternative connection via the Internet to an Access Point. The Internet connection acts as a back up to the dedicated line. Under normal circumstances the dedicated line carries the Eurex data traffic. As the Internet connection is only available on the MISS, UD configurations are not supported. This combined connection is the ideal solution for the average Eurex user.

"iAccess" is a MISS-only connection alternative, using exclusively Internet (no dedicated lines) to connect to an Access Point. This solution is adequate for lower volume members using the full functionality provided by the MISS technology at a very low monthly cost.

"@Eurex" is considered to be the "plug and play" service supporting access from a standard Eurex Workstation via the Internet to an exchange operated Multi-Member-MISS (eXISS – Exchange Integrated System Server). No MISS is configured on the member's site, and thus there is no access to VALUES-API for backoffice systems nor is it possible to use third-party applications. A smart-card will protect the log-on to the eXISS system. @Eurex is the cheap and easy access to Eurex.

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Equity for All!

The subject of a Pan European stock market, whether named iX, Euronext, VertX or Jiway System, has been continuously in the news recently. However, surprisingly there has been very little discussion on the idea of a Pan European derivative exchange for equity products aligned to one of the suggested alternatives! Of course they all implicitly have associations with existing derivative exchanges but surely those relationships will need to be reviewed in the light of these events? This article is intended to highlight some of the developments that have taken place and identify some of the potential trends that may happen in the future.

The influence of equity derivative contracts on their underlying cash markets has continued to increase as the volumes and recognition of the importance of these products have increased. This has been further supported in the equity index markets by the trend toward passive investment or indexation by mutual funds and will no doubt continue with the recent introduction of Exchange Traded Funds. The transparency and liquidity available within index derivatives provides a perfect proxy for portfolio allocation and replication strategies. Therefore, price movements in index products are generally seen as an indication of movements likely in the underlying cash rather than the other way around (otherwise referred to as the "tail wagging the dog").

In this environment one would logically determine that the stock exchange that is "supported" by the leading equity/index derivative exchange has a considerable benefit in its attempt to create the leading European exchange. In addition, as exchanges consolidate, corporate mergers and acquisitions continue and the Euro is more widely introduced the relevance of individual country indices will wane. This scenario would suggest that the European market would tend to follow the US example, whereby one major index future and option will dominate (i.e. the S&P 500) and the contract volume in that product will be considerable.

Indeed, given the situation that is currently taking place in the US, namely the buy back of US Treasury Debt, which has contributed to the dramatic decline in T-Bond futures volume, the significance of equity derivatives volume has further increased. If one assumes a similar situation in Europe, allied to the realization that European citizens will need to fund their own pension requirements, there is the potential for an explosion in volume. Equity derivatives will be the key growth area in the next five years and therefore greater significance should be given to their importance.

Currently, the Euro STOXX 50℠ futures and options enjoy a considerable lead in terms of percentage turnover in the available Pan European derivative products, representing around 90% of turnover in exchange traded contracts. Analysis of pure contract volumes show that since its introduction two years ago there has been a gradual increase of overall market share relative to country indices although this has not necessarily been at the expense of country indices.

While their volumes have remained relatively stable the Euro STOXX℠ has experienced exponential growth. However, looking at the success of the e-Mini products in the US, one has to assume that there is further room for improvement. Reference to the US is appropriate due to the CFTC approval of the trading of STOXX futures from the US in April of this year. This suggests that there is potentially an untapped market that is likely to add considerable volume.

Meanwhile, the retail market participation in the e-Mini products argues that further retail investor education should be made in Europe to explain the potential advantages of such products to smaller investors wishing to best utilize a percentage of their funds to develop sufficient pension returns.

In addition, the success of the e-Mini NASDAQ 100 raises the question as to whether similar European index products might also be successful? The introduction of NEMAX® 50 derivatives in June has also been greeted with relative success and suggests that there is scope for this to mirror the steady progress of the NASDAQ contract and build into the high tech proxy for Europe. Certainly the underlying market capitalization of the NEMAX® 50 dwarfs any of the comparable European indices.

Market capitalization is an important factor when considering the potential volume growth of the Euro STOXX℠ and NEMAX® 50 derivatives. The total market value of the European market is around 80% of that on the New York Stock Exchange, without considering the size of the NASDAQ market. The size of the European economy, the projected investments in equity in the coming years and the more recent trend for European companies to acquire US companies also indicates that there is room for growth.

Looking further into the crystal ball, one wonders whether there is room for more specific index futures contracts. Assuming that the technology sector is covered by a NEMAX® type future, what about the possibility for other sector futures? In addition, given the pension fund requirements, why not consider style indices, concentrating on growth and/or value stocks? While industry participants point to the examples of failures of such contracts in other domains and the changing nature of demand for such indices in the underlying markets, the new world of Pan European investment may promote the acceptance of such innovation?

Meanwhile, much has been written about the competitive listing of stock option products in the US, whereas a similar development in Europe has already begun and is likely to increase as the stock exchange consolidation continues. Eurex listed foreign stock options earlier this year with somewhat limited success, however that may have been due to participant's limited access to the underlying cash market in those stocks. Assuming a Pan European market such concerns will be allayed and therefore lead to a truer test of the ability of "home" markets to maintain the trading in their major stock listings and therefore the related stock options.

However, the overall market for stock option trading in Europe is poor when compared with the volumes seen in the US. Part of this is due to the excellent educational and marketing efforts made by the Options Institute, which is funded by all of the competing options exchanges. The plethora of discount brokerage operations providing facilities for stock option trading and the now further increased competition amongst option market making firms for order flow have contributed towards this success.

Perhaps most importantly, these elements combined have encouraged the development of retail order flow, which has been the lifeblood of the US option markets. In Europe, with the exception of Holland and Sweden, such retail participation has not been seen. Interestingly, in Germany and Switzerland in particular, most of this business has migrated to the OTC options area, or the warrants market. In the first half of this year, the number of warrants has apparently grown to more than 14,000 products, with the German warrants market volume already exceeding that of last year!

This raises a question as to whether the warrant market can continue to thrive in a pan European environment, where different national investors will have a different understanding of how leveraged investments or speculation is made and the liquidity will migrate toward an exchange traded platform? Certainly some of the benefits of concentrated liquidity, open interest and margin requirements within an exchange-traded environment should attract some of the warrant liquidity.

This suggests that an important role for any potential Pan European stock exchange should be to capture such stock option liquidity, as the related hedging business in the underlying stocks from the major market makers is considerable.

Finally, it will also be interesting to see what impact the introduction of other nations into the Euro camp will have? Having all stocks traded in Euro has enhanced the development of cross border investment and made index arbitrage and stock allocation strategies less complex. The trading of Swiss and UK stocks in Euro, while their underlying currencies are still fluctuating versus the Euro, suggests that there will still be reticence in some quarters (e.g. pension fund managers that have asset/liability matches in the same currency to consider). Given the significance of the Swiss and UK market capitalization within Europe, consideration as to whether a Euro STOXX℠ type index (Euro zone) can maintain its derivative dominance is perhaps questionable.

This article has raised a number of questions, some of which are more easily answered than others. However, while the focus of a Pan European exchange has been concentrated on the cash market, I believe that a Pan European equity derivatives market is as important and potentially more easily achievable. The true liquidity in the derivatives market is more heavily concentrated amongst a few players, and therefore support from this group may be more easily attained.

The stock exchange group that wins the derivatives battle will have won a big part of the battle for the underlying cash market. Whether this will represent "equity for all" remains to be seen but it is certainly good promotion for the European equity markets!

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Workshops for Investment Advisors in Switzerland **Extension of Trading Hours in Finnish Derivatives** Successful Launch of Electricity Trading on EEX **Dates in September and October**

Workshops for Investment Advisors in Switzerland

For the first time, and in addition to the private investor workshops scheduled for the second half of 2000, Eurex will be offering training courses for financial advisors of banks, broker houses and asset management companies. These events target retail banking investment advisors, eager to broaden their knowledge specifically in the field of exchange-traded options and financial futures.

The workshops are individually tailored to the specific requirements of retail advisors and will be held by an experienced trainer. Both half-day and full-day courses may be booked.

The workshop series for investment advisors will at first be exclusively offered in Switzerland. On particular demand, however, this offer may also be extended to Germany and other countries.

For further information, please contact Giovanna Cilia, T +41 (1)229-28 85, e-mail: Giovanna.Cilia@eurexchange.com

Extension of Trading Hours in Finnish Derivatives

In parallel to the extension of trading hours by the Helsinki Stock Exchange (HEX) for Finnish cash market products, Eurex also extended its trading hours for Finnish derivatives effective as of September 1, 2000. The change from the current 09.30-16.30 CET to 09.00-17.00 CET affects the following products:

- Finnish Stock Options / LEPOs
- FOX Future (FFOX)
- FOX Option (OFOX)

The end of the respective Post-trading periods remain unchanged at 18.30 CET (Stock options/LEPOs) and 19.30 CET (FFOX, OFOX).

For any further questions please contact Ralf Dreyer, T +49 (0)69-21 01-57 05, e-mail: ralf_dreyer@exchange.de

Successful Launch of Electricity Trading on EEX

On August 8, 2000 the European Energy Exchange (EEX) launched its electricity spot market. On the first day of trading, 12,233 megawatt hours (MWh) of electricity were traded.

Twenty-one participants from five countries traded electricity in blocks and individual hours for the next day in continuous trading and in auctions on the Xetra electronic trading system. After the close of trading, EEX reported the participants' delivery and purchase obligations to the grid operators, who then secure the orderly physical delivery of electricity for the next day.

The trading of Energy Futures on Eurex is planned for the 4th Quarter, 2000.

Dates in September and October

September 19–20, 2000
FOW's 7th Asia-Pacific Derivatives Exhibition, Raffles City Convention Centre, Singapore

September 21–23, 2000
IAM Internationale Anleger Messe, Messehallen, Düsseldorf

October 19–22, 2000
Gewinn-Messe, Exhibition for the Private Investor, Fairground, Vienna

Member Training **Training & Education** Derivatives Market

	Course	September	October
Traders Examination	Colloquium for Eurex Traders Examination	25.09.2000 **C** 26.09.2000 **C**	
	Eurex Traders Examination	18.09.2000 **P** 19.09.2000 **H/L** 20.09.2000 **L**	
System Training	Eurex Technical Member Training	21.09.2000 **P**	04.10.2000 **L**
	Eurex Functional Member Training	28.09.2000 **C**	10.10.2000 **F** 11.10.2000 **L**
	System Training for Eurex Clearing	29.09.2000 **C**	12.10.2000 **L**
	Clearer Test Evidence of Vocational Aptitude for Backoffice Staff	18.09.2000 **L** 19.09.2000 **H/P** 25.09.2000 **C**	
	System Training for Eurex Security	25.09.2000 **L**	

C Chicago **L** London **P** Paris

Eurex Workshops for Private Investors in Collaboration with "Börse Online"

After a successful series of workshops offered during the first half of this year, Eurex in collaboration with "Börse Online" launched yet another training program on options and financial futures for the second half of 2000.

Scheduled on two evenings each time, basics on options and financial futures, option valuation methods as well as trading strategies is taught. All of these events are intended for the interested private investor and are held in several German cities as well as Zurich, Geneva and Vienna.

The various courses are to be conducted by experienced Eurex trainers and moderated by "Börse Online" editorial staff. Eurex staff will be available to answer any questions on trading and Eurex products. Banks, discount brokers as well as other financial services providers will also attend the events and present their related offers on futures and options trading.

Workshop Locations and Dates:

Location	Date
Dusseldorf	21. + 22.09.2000
Vienna	19. + 20.10.2000
Zurich	24. + 25.10.2000
Geneva	26. + 27.10.2000
Stuttgart	30. + 31.10.2000
Leipzig	02. + 03.11.2000
Berlin	16. + 17.11.2000
Hamburg	20. + 21.11.2000

Workshop Schedule:

1st day: 5.00 p.m. to 9.30 p.m.	2nd day: 5.00 p.m. to 9.30 p.m.
• Basic information on Eurex options and financial futures • Introduction to derivatives markets and trading practices • Profit and loss valuation • Risk/reward profiles	• Fundamentals of option pricing • Strategies for hedging and yield increase • Frequently used option combinations

The fee for participation is DEM 120.00/EUR 61.36/CHF 95.40 per day, respectively. Workshop days may also be booked individually. The fee covers participation, detailed documentation and refreshments. Further information on the various courses, including corresponding registration forms, can be found on **www.eurexchange.com/top/ workshop.html**, or by calling T +49 (0)69-21 01-12 90 or T +41 (0)1-229-29 48.

For any further information on exhibition opportunities, please contact Lothar Kloster,
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