Discovering opportunities in extraordinary challenges

History will remember 2011 as an extraordinary year in financial markets. It began with signs of a continuing improvement away from the debris of the 2008 Lehman Brothers failure. But towards the end of the year global pressures again began to show as the euro came under enormous strain from sovereign and banking debt at the same time as US political rifts affected its own debt remedies. Meanwhile, China, for long a global growth engine, saw economic activity stumble, with an immediate effect on global economic confidence.

Banks, asset managers and savings institutions are having to deal with unprecedented stresses in world economies. Markets are facing dramatic increases in volatility at the same time as having to accommodate structural shifts in how they operate, notably the re-balancing of exchange and over-the-counter trading as regulators seek to introduce more transparency and to lower systemic risk.

Eurex Exchange – one of the largest global derivatives exchanges – recognises these new pressures and is responding with a range of new trading opportunities to meet the needs of volatile and distressed markets.

Derivatives exchanges have long established themselves as central to market transparency, liquidity and risk management. But as the world's financial markets have become truly global, with complex inter-related pressure points, the need to offer fast, effective infrastructure solutions has assumed global importance.

Eurex Exchange's size and spread make it one of the important tools when dealing with financial market questions of today. It lists over 1,700 products in 11 asset classes. It supports trading facilities in 30 countries, enabling around 8,300 traders to identify, price and manage risks globally.

The key to managing risk using derivatives comes in the post-trade end of the value chain – with clearing and settlement. As part of Eurex Group[1] and a sister organisation of Eurex Clearing, the exchange has refined its activities across the value chain into a smoothly efficient operation.

Fixed income pressures

In 2011, a clear focus emerged on sovereign debt instruments. In the eurozone and other currency blocks, major new pressures emerged as shorter term debt matured but new credit was very difficult to secure. The actions of rating agencies, difficult to predict at the best of times, also added occasional unexpected uncertainty and induced additional volatility to interest rates.

Eurex Exchange has long met the needs of fixed income managers to deal with shifts in interest rates and unexpected moves along the entire interest rate curve with contracts linked to German triple A underlying – the Schatz, Bobl, Bund and Buxl®. Over the past years, and anticipating market interest in other euro sovereigns which are non-triple A, the exchange also launched contracts linked to notional debt securities issued by the Italian government – the so-called BTP family.

Equity markets struggle

As many markets were painfully aware in 2011 the debt problems in markets overflowed into equity markets. Investors increasingly need to handle equity market risks in the context of sudden moves in the debt markets as tensions in sovereign debt markets commonly have an adverse effect on investor sentiment in equities. The suddenness and size of these shifts is relatively new, however, and reflect the potential for austerity-induced inhibitions to economic growth in the affected countries. The need to hedge equity market risk as flexibly as possible is paramount.

Eurex Exchange provides the platform where these price shifts are transparent and where the instruments exist to manage their risk. The exchange has for some time been substantially expanding its geographical spread of equity contracts.

From its established base of EURO STOXX® and DAX® contracts, Eurex has expanded its international scope, now offering trading in, for example, Korea's KOSPI 200, the world's most heavily traded equity index contract, but also MSCI Russia, SENSEX etc. In addition, some 850 single stock futures and 400 options on stocks from Europe, the USA, Canada and Brazil are traded on its platform, often with tighter spreads and more liquidity than on their domestic markets.

Companies and sectors with stable dividend histories came under pressure in 2011. While fund managers are normally well informed about such developments, the severity of market conditions and high levels of volatility make for new levels of uncertainty. The availability of dividend derivatives on Eurex – both single stock and equity index – offered managers the opportunity to hedge this risk – and they responded in dramatic fashion: in 2011, Eurex's EURO STOXX 50 Dividend Futures set new records in turnover and open interest.

Commodities change their role

In recent years the world's growth markets were major commodity consumers such as China and India, or commodity rich regions such as Russia and Brazil. Globalisation meant that these economies were not immune from the credit crisis and the threat of western recession. The ability to hedge commodities as recession threatens is therefore extremely valuable.

The traditionally low correlation between bond and equity markets and commodities has come under pressure in recent years, testing their attractiveness as an asset class for investors when bond and equity alpha is hard to find. However, investors continue to recognise the 'early warning' characteristics of commodities, where their price trends often anticipate slower trending equity markets.

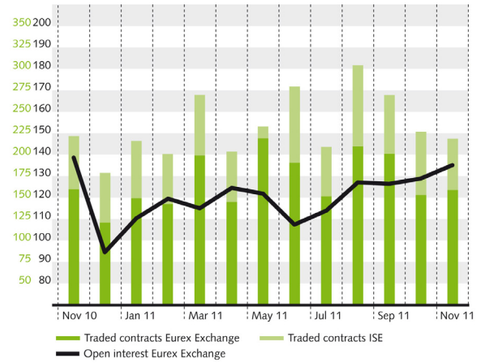
Eurex Exchange's particular strength in commodities comes from the breadth of its offering. In addition to several commodity index contracts, in partnership with Dow Jones, it also offers contracts in agricultural products and precious metals. A suite of energy contracts, which includes German and French power and European CO_2 are offered in conjunction with European Energy Exchange – the newest member of Eurex Group – complementing this growing segment. The availability of such contracts on the same exchange platform as fixed income and equity-based derivatives allows users immense flexibility to manoeuvre between asset classes as market circumstances dictate.

Superior technology drives volume

An exchange group offering trading and clearing is not in itself a 'field of dreams'; it's not enough just to design good contracts and services. The infrastructure supporting these contracts has to be world class too.

> **Exchanges are increasingly seen as part of the route towards safer and more transparent markets.**

Overview 1: Volume development November 2010–November 2011 – Eurex Group financial derivatives exchanges



Eurex Group created the first fully electronic cross-border exchange and cross-border clearing house in the 1990s, and has remained in the forefront of exchange, risk and clearing technology ever since.

One consequence of these ongoing IT developments has been a surge in algorithmic and high frequency trading, taking advantage of the benefits derived from co-location facilities at the exchange's data centres. Eurex Exchange offered co-location facilities some time ago, recognising that computerised trading was an important constituent in today's markets.

It is precisely this soundness of reputation which is driving a broader theme – how markets cope with systemic risk. A very considerable political effort, in the US, Europe and further afield, is being expended on finding ways to reduce financial markets risk. Exchanges, with their transparency, front-line regulatory powers, range of contracts, accessibility and provision of clearing, risk management and settlement services, are increasingly seen as part of the route towards safer and more transparent markets.

In any event, it seems that the world's financial and commodity markets will increasingly operate on regulated, technically advanced exchanges with robust clearing facilities and a broad range of products.

[1] Eurex Group includes six businesses: Eurex Exchange, International Securities Exchange, European Energy Exchange, Eurex Clearing, Eurex Bonds and Eurex Repo.

For more information about Eurex Exchange's diverse product and service offering, please visit www.eurexchange.com