# Coffee, wheat and bucketsful of money

**How to trade in futures**

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Had a guts full of the miserable returns on New Zealand-based equities? If you've got the stomach for more speculative investments, the futures market offers almost instant returns.

But professional futures investor Mark Sleeman says uninitiated investors looking to futures merely to regain the excitement shares once offered should also prepare for a one-way trip to investor oblivion. He says unless you're prepared to do your homework on futures, you may as well spend a night playing craps at Sky City.

Yes, folks, there ain't no easy money in futures — but there *is* money, nevertheless.

Speculating in futures part-time since 1990, Sleeman gave up his job in the construction business, sold his house and, since September 1997, has become a full-time trader. He's one of the 1000 or so private investors and high net worth individuals who trade futures contracts locally. These contracts are actually traded by brokers who are members of the New Zealand Futures and Options Exchange (NZFOE), a limited liability company owned by the Sydney Futures Exchange. Here in New Zealand there are 10 futures dealers, but only one, broker Ord Minnett, trades futures on behalf of private investors like Sleeman.

So how do futures markets actually work? Simple really. People make money on the ups and downs of commodity prices. Modern futures trading has its roots in the Chicago of the late 1800s, where farmers, known as hedgers, would secure future prices on their grain and other commodities from future buyers. The market worked because it provided revenue certainty for the seller and price stability for, say, a baker who'd turn that grain into bread.

Since then, private investors like Sleeman have been able to get in on the act. Although the commodity range has widened to include metals, grains, crops, other scarce resources, plus bond and equity markets, today's futures work exactly the same way. Today's price is the market's best guess of what the commodity's price will be at delivery date. Factors determining price fluctuations include anything from climate, natural disasters to wars and economic booms and busts.

"I prefer the futures markets because they are so much more diverse than equities. When the Dow Jones or the NZSE goes down, most stocks are affected. When sugar is down, it has no effect on oil and coffee. That gives me more opportunity for profit."

During Sleeman's first year of full-time trading in 1998, he made a 31% return by successfully reading fluctuations in world markets, spurred by currency crises in Asia and Russia. So far this year the tables are turned. In fact, he's down 10% in earnings due to difficulty anticipating future trends — which is, of course, the secret.

So how might Sleeman cash in? Had he known gold prices in late September would rise from around $US260 to more than $US300 an ounce, he would have made a killing buying gold futures. What he didn't know was that plunging gold prices would be suddenly reversed by an agreement among 15 European central banks to limit gold sales to 400 tonnes a year for the next five years.

One advantage of futures is that they don't require huge cash flow. Because buyers and sellers contract to do business at some time in the future, they're only required to pay a deposit. It works like this. A futures trader contracts to buy 100 troy ounces of gold on December 15. At today's $US300 an ounce this will cost the trader $US30,000, but they pay only a 5% deposit of around $US2000.

If the price of gold moves to $US295 tomorrow the trader is down $US500 for the day and would have to put up additional funds to hold the margin at a constant level. But had the trader contracted to sell — not buy — at $US300 an ounce, they'd have had $US500 credited to their account that night.

Sleeman says smart futures traders limit how much they'll lose on any single trade by placing stop-loss orders when the contract's entered. This means they limit how much they're prepared to lose before bailing on the contract. Small losses tend to be more frequent, but these are usually offset by larger, yet rarer, gains. And in the case of coffee, which went up 300% two years ago, gains can be massive.

"I limit my losses over a two-day price range and keep them to 1% of total my assets. The real art is surviving small and regular losses so that you're around to enjoy the upside when it finally arrives."

After 10 years in the game would he recommend punters have a crack? "Yes, but do it first through a managed fund. It has taken me 10 years to feel like I know what I'm doing, and even then you have times when every market seems to move against you."

**Commodity tip**

**Online futures**