



A futures exchange or derivatives exchange is a central financial exchange where people can trade standardized futures contracts; that is, a contract to buy specific quantities of a commodity at a specified price with delivery set at a specified time in the future.

The Coffee C contract is the world benchmark for Arabica coffee. The contract prices physical delivery of exchange-grade green beans, from one of 19 countries of origin in a licensed warehouse to one of several ports in the U. S. and Europe, with stated premiums/discounts for ports and growths. The contract offers the trade a standardized medium for trading and is the industry wide accepted basis for buying and selling coffee.

Each futures “lot” is equal to 37,500 pounds of coffee, which is roughly 250 bags or 1 container. Contracts are priced against the C market by differentials to the board depending on a number of factors including origin, grade, destination etc.

Futures have a few basic functions. The C contract is used as a pricing mechanism, a risk hedging tool and as a speculative vehicle.



A simple example of pricing :

Contracted to buy 1 lot of Colombian Coffee at a differential of “plus 10”

Spot C Price = 130.00

Price would be fixed at \$1.40 per pound

\$1.30 spot price

+ .10 diff

\$1.40 x 37,500 lbs.

= \$52,500.00 is the price of the purchase of 1 container of Colombian Coffee.



The market also offers the opportunity to hedge ones exposure to price fluctuation.

A simple example of a hedge :

A coffee farmer would be very happy to sell his harvest at the current market price of \$1.35 per pound but his crop is not due to be harvested for 2 months. He could sell futures in the amount equivalent to his crop to hedge the possibility of prices falling.

Example:

Current Market Price = \$1.35

Sell Futures @ \$1.35

2 months later :

Current Market Price = \$1.20 , he “lost” 0.15 cents on his physical inventory

Buy Futures @ \$ 1.20 to cover short, he made 0.15 cents profit so he still booked the level of \$1.35 on his sales.



A third function of the market is speculation. This enables one to position themselves in the market looking for price movement regardless if they are involved with the physical commodity or not. Speculators provide liquidity to the market and enable risk to be offset. Futures are a “zero sum” game meaning for every long there is an offsetting short, for every profit, a loss. So speculators are willing to accept risk betting on the direction of the market.

Speculators come in a few different forms from small traders trading their own accounts to technical (or black box) funds to index funds which spread large sums of money over many markets on a percentage basis and are long only, to hedge funds. Hedge funds get a lot of attention in the media. Hedge funds are defined as :

“ A hedge fund is a fund that can take both long and short positions, use arbitrage, buy and sell undervalued securities, trade options or bonds, and invest in almost any opportunity in any market where it foresees impressive gains at reduced risk.”



While the underlying commodity and supply and demand will ultimately dictate the price direction of a market over recent years outside influences are becoming more prominent. For Coffee agricultural methods have improved with better fertilization and irrigation and the migration of the Brazilian crop northward has greatly lessened the risk of frost. The market has seen increasing fund involvement and been more conscious of macro commodity moves and dollar fluctuation. Especially over the last 2-3 years as hedge fund involvement in commodities has generated some major moves in contrast to fundamental outlooks. This has made reports such as the Commitment of Traders report more watched by the markets. The level of spec and fund involvement has become as important as crop surveys in helping people shape their market outlooks.





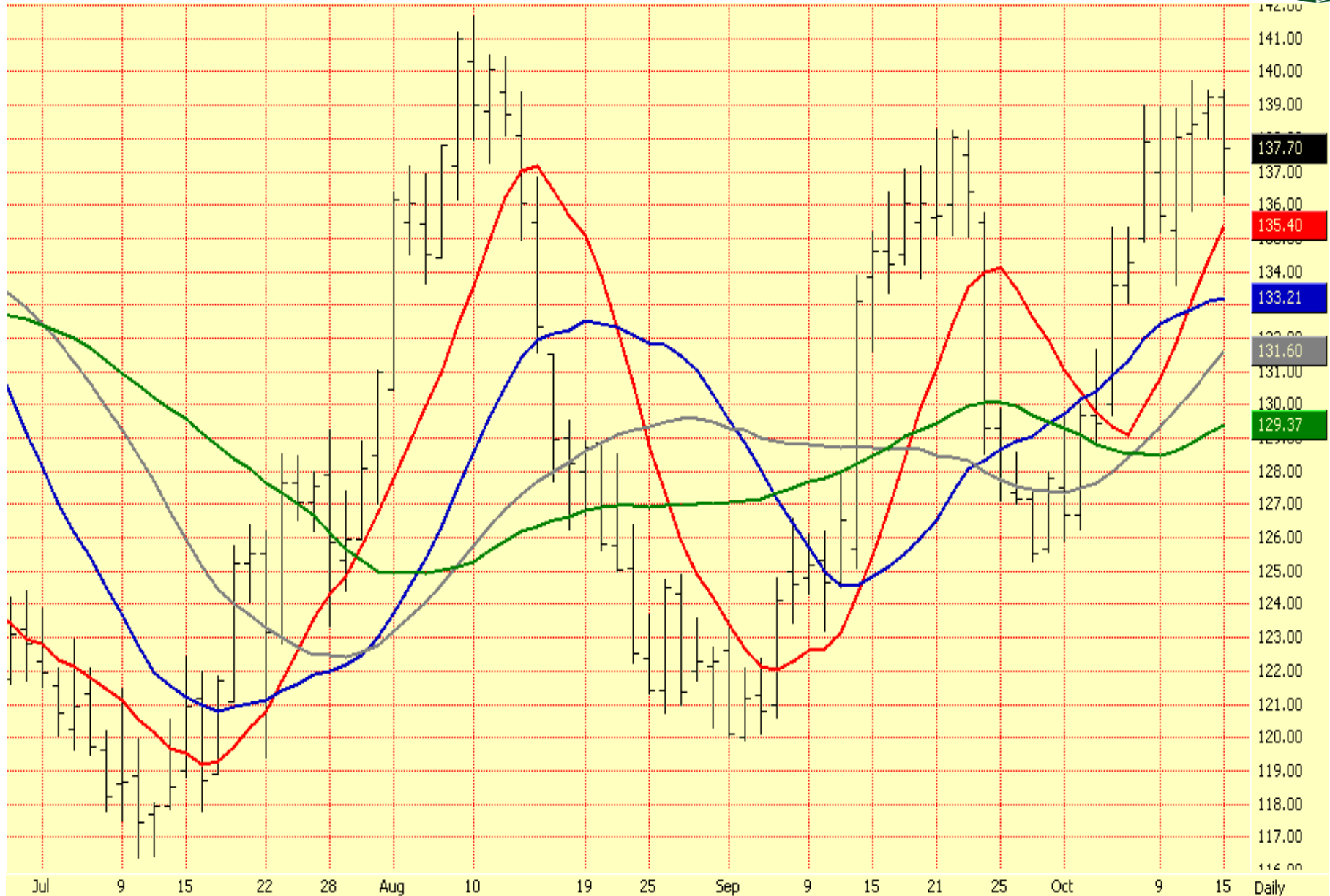


This brings us to another aspect of the market place, technical analysis. Technical analysis of the market is based on price movement in relation to mathematical formulas, chart formations and patterns and trend projections.



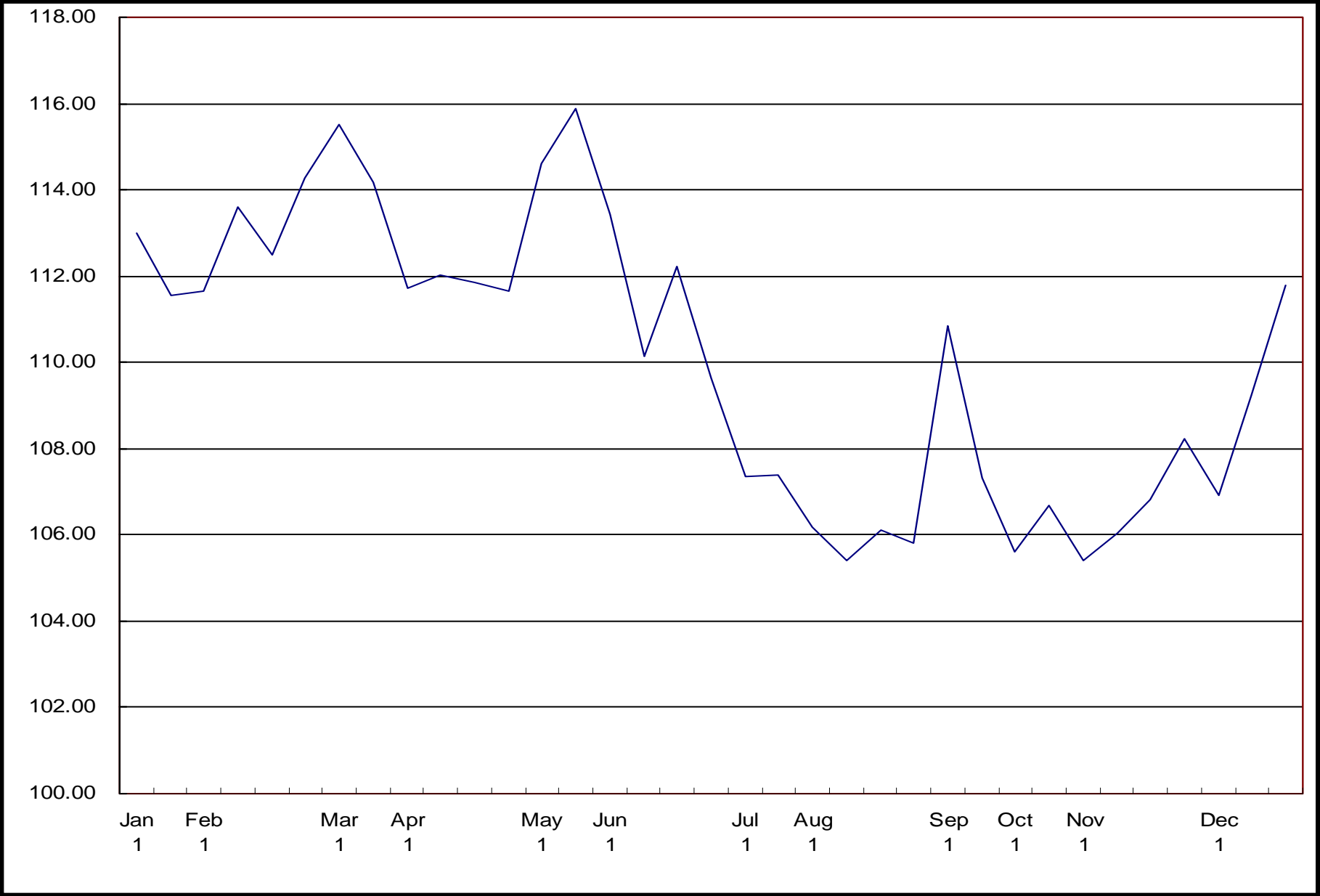








Seasonal Trend



Technical Analysis of the Financial Markets

by John J. Murphy

Trading for a Living: Psychology, Trading Tactics,
Money Management

by Dr Alexander Elder

Elliott Wave Principle: Key to Market Behavior

by AJ Frost and Robert R Prechter



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