CME looking beyond floor

Prior to the Chicago Mercantile Exchange going public more than a decade ago there was a shake-up in its leadership. Terry Duffy was elected chairman of the exchange in 2002, replacing Scott Gordon. CME had already demutualized and was in the middle of the process of moving from a member-owned mutual organization into a publicly traded company while moving from a floor-based exchange to an electronic marketplace.

It was widely reported that the move was engineered by Chairman Emeritus Leo Melamed and former chairman Jack Sandner, as well as other veteran board members.

At the time there were some stories regarding the move as a setback to progress and a revolt by floor traders against the inevitability of electronic trading. The argument really did not make sense; there was no stronger proponent of electronic trading over the years than Melamed who—after initially rejecting the concept—grew to believe it was necessary for the survival of the exchange. But when it appears that "the old guard" is asserting influence to alter the direction of an institution, there is a natural tendency by some to assume it is a move intended to thwart progress and look backward. There were other issues regarding competing visions for the future of CME that drove the conflict, but the idea that it was an attempt to halt progress of electronic trading, that, while silly and simply wrong, was hard to shake.

When CME Group announced it was closing the floor, many people, myself included, thought that it was just the natural evolution of the futures markets, which we have been witnessing over the last 20 years. In a sense it is: the exchanges that make up CME Group have successfully transitioned from floor-based operations to electronic markets. The screen is where prices are discovered, except for in complex options and spreads. Many had expected the move and saw it as an inevitable evolution of markets. Some thought the floor should have been closed much earlier. Perhaps more importantly, closing physical trading pits is seen in the stock analyst community as an efficiency good for the bottom line.

However, those still making a living on the floor take a different view. They obviously are looking after their own interests, but as we noted above, the transition had already occurred. So, what trading still takes place on the floor does not come from stubbornness, but is due to value being offered. Traders, both institutional and retail, are comfortable with the screen and use it for most of their needs. Most financial futures transitioned to the screen in the early 2000s and ags moved as soon as they were able. The point being, what orders are still being executed on the floor are done so for a reason beyond nostalgia.

Very few floor traders believe their time on the floor is long, but would like the chance to remain as long as they can add value, and in "End of an era" (page 18) they make the case that the are adding value.

One broker we spoke to talked to the CME about what they need to provide in Globex to make the transition smooth. So while it is easy to dismiss these "Last of the Mohican" floor traders as simply people hanging on to an old way of doing business, the truth is a little more complicated. This is a bottom line business and institutional traders and professional money managers are not going take on added expenses to keep a few old line floor traders happy.

There is a belief by some floor traders and traditional end users that CME Group is bending to the wishes of the high-frequency trading community. It is hard to say. CME has an obligation to listen to all of its customers and HFTs make up great deal of exchange volume. Their concerns are important as are the concerns of all traders and those who use the markets. However, if traders feel they are being exploited, they will look for an alternative.

While Class B shareholders are no longer owners of the exchange, they are still customers and many of them service other customers. It is important for the exchange to listen to their concerns and the concerns of all their end users. The end of the floor may be inevitable, but CME must make sure whatever efficiencies the floor is providing to end users are replaced.

From what we hear, there is still work to do in terms of electronic functionality.

April is the month we preview the currency market and this April there are very few sectors that look as intertesting. In "Currency volatility break-out" (page 14) Jaime Toplin provides an outlook on currencies. What she found is a bifurcated world with the U.S. Federal Reserve looking to exit accommodation right as central banks in the Eurozone and China are adding accommodation. This, as they say, is what makes a market.

The U.S. Dollar Index has surpassed 100 (briefly) for the first time in more than a decade, which will have a huge impact on both stocks and commodities.

Finally Steve Beckner tries to look beyond the Fed's anticipated first increase. Beckner makes the point that the Fed has been fairly transparent and a mid-2015 tightening, possibly as early as June, is expected. Nothing has been quite as befuddling as the markets' spastic reaction to the potenital timing of a future 25-basis point move in the Fed funds rate.

Get it over with already!

Daniel P. Collins

Contact me at dcollins@futuresmag.com or @futureswriter.