What is the Futures Market? Hedging and Risk Management

Futures contracts are tools for **trading and speculation** or **risk hedging**; futures contracts allow retail traders and large companies to manage the **risk of price increases or decreases** by **fixing prices in the future**.

Additionally, **futures contract data** is used to **predict market sentiment** or **trends** in financial markets.



Futures contracts In the futures market are traded

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Introduction to Futures Contracts and the Futures Market

Futures is a financial market that **futures contracts** (contracts for buying and selling assets such as commodities, **Forex market**, stocks, or indices) are traded.

What is a Futures Contract?

A futures contract is an agreement between a buyer and a seller to trade a specific asset at a **predetermined price** on a **maturity date**; entering into this contract involves costs such as **initial margin**, **transaction fees**, and maintenance margin:

- **Initial Margin**: The initial margin, paid as collateral to enter the contract, is typically 2% to 10% of the contract value and is refunded upon sale or maturity;
- **Transaction Commission**: The broker's fee for executing the contract, may be **fixed** or vary based on **transaction volume**;
- **Maintenance Margin**: This amount must be maintained in the account to keep the contract open and is usually **less** than the initial margin;

Futures contracts are used for risk management, hedging, and speculation (trading).

What is the Futures Trading Market?

In the **futures trading market**, **futures contracts are traded**; since there is no obligation to hold the contract until maturity, the trader can **sell the contract before the maturity date** in the **futures market**; in this case, the trader's profit or loss will be equal to the **change in the contract's value**.

Example of Futures Trading

A futures contract for trading 100 barrels of oil at a price of $50 is valued at $5,000. If the oil price rises to $60, the contract's value increases to $6,000. In this situation, if the trader sells the contract, they will gain a profit of $1,000 (the difference in contract value).

Difference Between Futures Contracts and Futures Trading

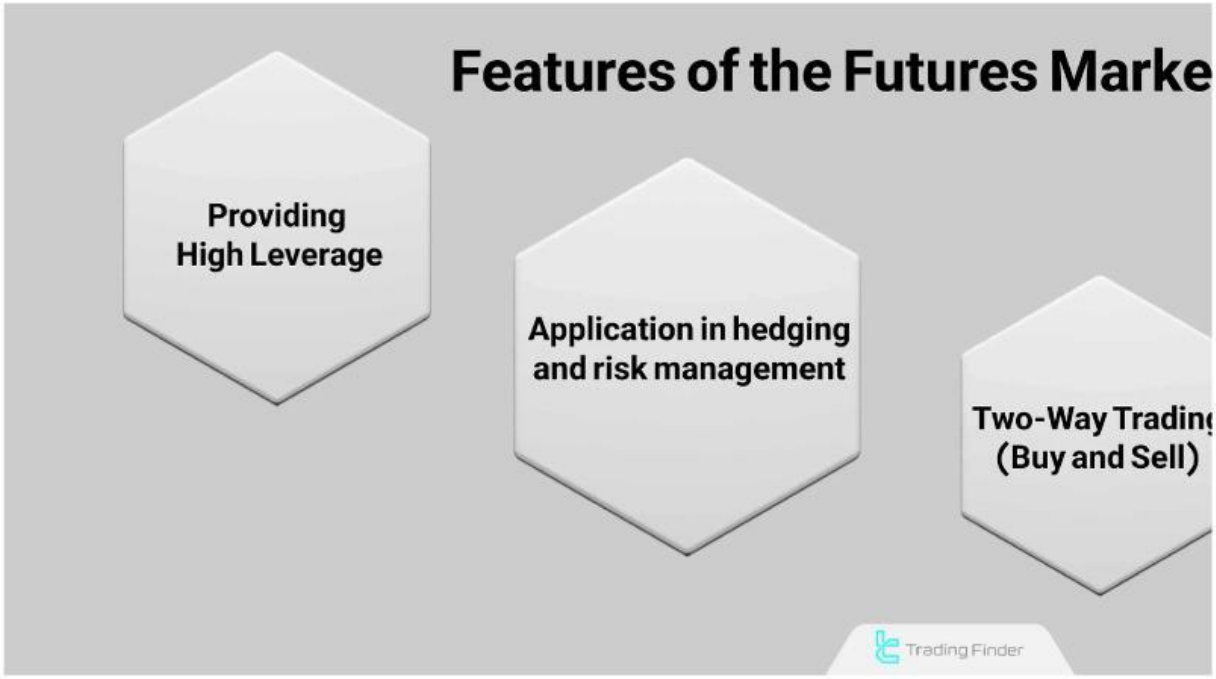
A futures contract is an agreement between a buyer and a seller to trade an asset at a **specific date** at a **predetermined price**. However, in **"futures trading"**, **futures**

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contracts are traded.

Features and Benefits of the Futures Market

Hedging (risk management), the use of **leverage**, **two-way trading**, and **diverse markets** are attractive features of the futures market.



High leverage and two-way market are features of the futures market

Features of the futures market:

- **Use in Hedging and Risk Control**: **Risk control** is a key feature of the futures market, allowing producers to **lock in prices** for selling products or buying raw materials to avoid price fluctuations;
- **High Leverage**: In futures trading, traders can use leverage to gain more funds;
- **Two-Way Trading**: Futures trading also allows **selling**; for instance, an oil company can agree to sell its product on a specific date at a predetermined price.

Which Markets Offer Futures Trading?

Futures trading takes place in regulated exchanges, and **centrally**; approved stock exchanges are responsible for regulating and supervising trading. **The most famous futures trading exchanges:**

- **Chicago Mercantile Exchange (CME)**: This exchange is located in the United States and has a large volume of trading and liquidity; in **CME**, futures contracts

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for **commodities**, **currency pairs**, **stocks**, **interest rates**, and **energy products** are traded;

- **Intercontinental Exchange (ICE)**: An international market known for **agricultural product futures**;
- **Eurex**: The futures market for **European stock indices** and **interest rates**;
- **London Metal Exchange (LME)**: The global market for **metal futures**;
- **Singapore Exchange (SGX)**: The futures market for **Asian indices** located in Singapore; **interest rate**, **commodity**, and **metal** contracts are also traded on the Singapore International Exchange.

Application of Futures Contracts in Hedging and Risk Management

Futures contracts are widely used in **hedging** and **risk control** due to their feature of **fixing prices** at a specific future date.

For example, a **producer** has a specific prediction about the increase in oil prices in the next three months; in such a situation, this producer can **hedge against the risk (risk of price increase)** by entering into a **futures contract** to buy oil at the **current price** with a **maturity of three months**.

At maturity, if the price of oil **increases**, they profit, and if it **decreases**, they lose; because the execution of the contract at maturity is mandatory.

Difference Between Futures Contracts and Options

The most important difference between **futures contracts** and **options** is whether the trade is **mandatory** or **optional** at maturity. **Key differences between futures and options:**

Feature	Futures Contract	Options Contract
Risk	High (depending on price fluctuations)	Lower, limited to premium cost
Execution at Maturity	Mandatory	Optional

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Upfront Payment	Initial margin (usually lower than premium cost)	Premium cost (usually higher than initial margin)
Trading Volume	Usually higher	Usually lower
Flexibility	Limited	Higher

Application of Futures Contracts in Market Analysis

Tracking futures trading data in **fundamental analysis** has a wide range of applications in **predicting market expectations for interest rates** and commodity prices.

Predicting Interest Rates Based on Futures Contracts

For example, **expectations for changes in US interest rates** are published on the **CME website** and are derived from **Federal Reserve interest rate futures contract data**. **The market's expected interest rate** is calculated using the following formula:



Market expectations for the Federal Reserve's interest rate are calculated using this formula based on futures market data

Identifying Supply and Demand Levels Using Futures Data

Futures market data can be used to **predict supply and demand levels**, as at maturity, the product or asset in question is traded at the **predetermined price**.

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If there is a large volume of contracts at a specific price level at maturity, it can be concluded that there is a significant amount of **supply** or **demand** at that level.

Conclusion

The **futures market** offers an attractive platform for **trading** or **hedging** with features such as **price fixing in the future** and the **ability to sell before maturity**.

Additionally, analysts identify key **supply** and **demand** levels by **tracking the maturity of options and futures contracts**.

source:

1.our website link :
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