

Futures

Investor Education Basics

Futures contracts are derivative instruments. They represent a commitment to buy or sell a predefined amount of the underlying asset (e.g. stocks, commodities, currencies etc.) at a predetermined price on a specified future date. When you buy a futures contract, you are holding a long position and have to buy the underlying asset on the final settlement date. On the other hand, you can choose to hold a short position by selling a futures contract - this means that you have to sell the underlying asset according to the contract terms.

Exchange traded futures are standardised future contracts that are listed in exchanges. Major future exchange markets in the world include New York Mercantile Exchange (NYMEX), Chicago Mercantile Exchange and Chicago Board of Trade (CME Group), Intercontinental Exchange (ICE), EUREX and Hong Kong Futures Exchange (HKFE).

How does it Work?

Despite the diversity in futures contracts, there are common characteristics in many exchange-traded futures contracts:

Underlying asset	It can be stocks, indices, currencies, interest rates, commodities such as oil, beans and gold. Futures contracts traded on HKFE are financial futures with underlying assets mainly based on interest rates, gold, stocks and stock indices such as the Hang Seng Index (HSI), H-shares Index.
Contracted price	The traded price at which a futures contract is registered by the clearing house.
Contract multiplier	The weight that is multiplied by the contracted price when calculating the contracted value.
Contract month	The period of every futures contract. Either physical delivery of the underlying asset or settlement by cash must take place on or before the futures contract expires at the end of the month.
Last trading day	The last day when a futures contract can be traded on an exchange.
Final settlement day	The day when the buyer and the seller must settle the futures contract.
Final settlement price	The fixed price determined by the clearing house and used to calculate the futures contract's final settlement value. Multiplying the final settlement price by the contract multiplier gives the final settlement value.
Settlement method	A futures contract can be settled by cash or by physical delivery of the underlying asset. All futures contracts traded on the HKFE (except for Three-year Exchange Fund Note futures) are settled in cash.
Initial margin	When you enter into a contract (either long or short position), you are required to deposit an initial margin - a small percentage of the contract value. Each exchange provides a minimum initial margin as a reference. An additional initial margin on top of such minimum requirement may be required by your broker depending on price volatility of different contract types. In general, initial margin varies by product and is subject to change from time to time.
Maintenance margin	It is the minimum level of net equity that is required to keep a contract open.
Margin call	If the subsequent price movement of a futures contract is unfavourable to that open contract, the floating loss may cause the net equity to fall below the maintenance margin thus giving rise to a margin shortfall. A margin call will hence be triggered and you will have to make up the margin shortfall in time.
At a premium	The futures contract's price is higher than the spot price of the underlying asset.
At a discount	The futures contract's price is lower than the spot price of the underlying asset.
Rollover	Rollover involves closing out an expiring position in futures contracts before the last trading day and opening a new position with a later expiry date but with the same contract specifications. You will realise your profit or loss during rollover when closing the expiring position, and fees and charges may be involved when closing and opening positions.

Scenario Analysis

Assuming customer buys a contract of Hang Sang Index (HSI) Futures (Oct) at a quote of 23,000. The contract multiplier is HKD50 per index point, and the initial margin and maintenance margin is HKD108,250 and HKD86,600 respectively. Below are examples to illustrate the investment returns basing on different scenarios of HSI futures movement.

Scenario	1	2	3
Initial open position (HKD)	23,000 x HKD50 (contract multiplier) = +1,150,000		
Initial margin (HKD)	108,250		
Maintenance margin (HKD)	86,600		
HSI Futures Movement	No Change	Favourable	Unfavourable
HSI Futures at close	23,000	23,300	22,700
Spread	0	300	-300
Realised profit / (loss) (HKD)	+0 (+0 x HKD50)	+15,000 (+300 x HKD50)	-15,000 (-300 x HKD50)
Return on investment (HKD)	NA	+14% (+15,000 out of 108,250)	-14% (-15,000 out of 108,250)

From the above scenario, if the unrealised loss in the contract is equal to or more than HKD21,650 (i.e. initial margin minus maintenance margin required), margin call will be triggered*. This can be further translated to a drop of 433 points in HSI Futures as follows.

Latest HSI Futures	22,567
Spread	-433
Unrealised loss (HKD)	-21,650 (-433 x HKD50)
Margin Call	Triggered

Margin calls are to be met by customers in order to maintain the position. Any unsatisfied margin calls might be subject to liquidation.

*Assuming the customer only maintains this contract with initial margin of HKD108,250 in his account.

What you need to consider when trading futures contracts?

- **Fitting your risk appetite**

The product is only suitable for customers of speculative risk appetite. That is, you may sustain losses in excess of your initial margin. Please refer to the section headed Risk Disclosure Highlight for more details.

- **Risk of magnified profit and loss**

You have to be prepared to take the risk of this product due to the gearing effect on the trading profit and loss. It follows that the lower the margin amount is used to open a position, the higher will be the gearing. A relative small movement of the price of underlying asset may result in profit or loss that is high in proportion to the minimum margin requirement.

- **Directional view in a certain asset**

If you expect the stock market to rally, you can opt for directional trading by buying a stock index futures contract. You will make a profit if the final settlement price is higher than the contracted price when you bought the futures contract. Or if you think the market will fall, you can sell a stock index futures contract.

- **Hedging purposes**

Hedging strategies are commonly used to offset any negative effects on an investor's portfolio return. If you want to mitigate your loss in a falling market, then you can use a short hedge by shorting a stock futures contract. Or you can apply a long hedge to lock in the buying price for the underlying stock on a future date by buying a stock futures contract. If the stock price rises, you will be able to buy the stock for less than the going market price.

If you are trading in futures, you must remember to pick futures contracts in which the underlying assets correspond to your holdings. For example, HSI futures are not the ideal tool to hedge red chips which are not HSI constituent stocks.

- **Access to different asset classes**

You can access different asset classes via futures investment. For example, you might not be able to participate in physical investment of cotton or coffee beans but you can capture the relevant market opportunities via cotton or coffee beans futures listed in ICE Futures Europe.

If you have any questions in relation to the above, please contact our relationship managers.

For more information about futures, you can also visit

For product concepts

Investor Education Centre (<http://www.hkiec.hk>)

For product traded in HKFE

Hong Kong Exchanges and Clearing Limited (<http://www.hkex.com.hk>)

Trading with HSBC Broking Futures (Asia) Limited (“HSBC Broking Futures”)

HSBC Broking Futures offers broking services covering a comprehensive range of exchange-traded futures contracts trading at major exchanges around the world. Our team has rich expertise and proven success in helping sophisticated and experienced investors execute their investment strategies with the use of derivatives.

Comprehensive Range of Futures Contracts

We support trading services in major futures markets in the world such as NYMEX, CME Group, ICE Futures US, ICE Futures Europe, EUREX, HKFE, Osaka Securities Exchange and Singapore Exchange. There is a wide coverage of underlying assets including stocks, benchmarks or indices, currencies, interest rates, commodities such as crude oil, copper, soybean, cotton and precious metals.

Flexible Fund Utilisation

Leverage ratio of up to 20 times of initial margin to allow you to enjoy more investment opportunities.

Various Instruction Alternatives

You can choose at your own discretion to place a market order, limit order or stop limit order to best fit your needs in various futures markets.

Simple Fee Structure

A flat fee will be charged per contract when you trade futures contracts with us. Please feel free to contact our relationship managers for the fee schedule.

Please feel free to contact our relationship managers for more details.

Risk Disclosure Highlight

You should carefully consider whether futures contract trading is suitable for you in light of your financial condition, experience and investment objectives. The following is a summary of some of the risks involving futures contract trading and it is NOT an exhaustive list. You are advised to exercise caution before investing in this product.

1. The risk of loss in futures contract trading can be substantial. The risk of loss in financing a transaction by a deposit of collateral can be significant. You may sustain losses in excess of your initial margin funds, cash and other assets deposited as collateral with HSBC Broking Futures.
2. You may be called upon at short notice to deposit additional margin deposits or interest payments. If the required margin deposits or interest payments are not provided within the prescribed time, your position or collateral may be liquidated without your prior consent. You will remain liable for any resulting deficit in your account and interest charged on your account. You should therefore carefully consider whether such trading is suitable in light of your own financial position and investment objectives.
3. Margin trading can involve a high degree of risk. Price changes in the underlying asset can result in substantial losses to you that may in some instances exceed the amount of your initial margin funds, cash and other assets deposited as collateral with HSBC Broking Futures. You should not participate in margin trading unless you understand and are willing to assume the risks associated with such transaction and are financially able to absorb such losses.
4. Market conditions (e.g. illiquidity) may make it difficult or impossible for HSBC Broking Futures to quote the bid and ask prices for a futures contract. Placing contingent orders, such as "stop-loss" or "stop-limit" orders, will not necessarily limit losses to the intended amounts. Market conditions may make it impossible to execute such orders.
5. The amount of initial margin is small relative to the value of the futures contract so that transactions are 'leveraged' or 'geared'. The lower the initial margin amount is used to open a position, the higher will be the gearing. The high degree of leverage which is often obtained in connection with margin trades can work against you as well as for you. The use of leverage can lead to large losses as well as gains.
6. Your assets received or held by HSBC Broking Futures outside Hong Kong are subject to the applicable laws and regulations of the relevant overseas jurisdiction which may be different from the standard of the Securities and Futures Ordinance of Hong Kong and the rules made thereunder. Consequently, such client assets may not enjoy the same protection as that conferred on client assets received or held in Hong Kong.
7. You may be affected by any curtailment of or restriction on HSBC Broking Futures' capacity to trade in respect of open positions as a result of action taken by the Securities and Futures Commission, the Hong Kong Monetary Authority or other governmental or regulatory bodies under Applicable Rules or for any other reason. In such circumstances, you may be required to reduce or close your Open Positions with our company.
8. You should consider the possible risk inherent in giving instructions by facsimile. Non-original signatures on facsimiles may be forged and instructions given by facsimile may be transmitted to wrong numbers, may never reach HSBC Broking Futures and may thereby become known to third parties thus losing confidential nature. HSBC Broking Futures accepts no responsibility for the occurrence of any such circumstances or for any action, claim, loss, damage, or cost incurred by the Customer in connection with instructions given via facsimile. HSBC Broking Futures shall not be held liable for acting in good faith on faxed instructions which emanate from unauthorized individuals or in any circumstances whatsoever.

Important Notes:

Before you trade, please read the Terms of Business which had been provided to you by HSBC Broking Futures. In case of discrepancy between the Terms of Business and this document, the Terms of Business shall prevail.

In the event of conflict or inconsistency between the English and Chinese versions of this document, the English language version of this document shall prevail for all purposes.

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