Title:
Forex Versus Futures

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641

Summary:
The origins of today's futures market lies in the agriculture markets of the 19th century. At that time, farmers began selling contracts to deliver agricultural products at a later date. This was done to anticipate market needs and stabilize supply and demand during off seasons.

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Article Body:
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The current futures market includes much more than agricultural products. It is a worldwide market for all sorts of commodities including manufactured goods, agricultural products, and financial instruments such as currencies and treasury bonds. A futures contract states what price will be paid for a product at a specified delivery date.

When the futures market is played by speculators, the actual goods are not important and there is no expectation of delivery. Rather, it is the futures contract itself that is traded as the value of that contract changes daily according the market value of the commodity.

In every futures contract there is a buyer and a seller. The seller takes the short position and the buyer takes the long position. The futures contract specifies a buying price, a quantity and a delivery date. For example: A farmer agrees to deliver 1000 bushels of wheat to a baker at a price of $5.00 a bushel. If the daily price of wheat futures falls to $4.00 a bushel, the farmer's account is credited with $1000 ($5.00 - $4.00 X 1000 bushels) and the baker's account is debited by the same amount. Futures accounts are settled every day.

At the end of the contract period, the contract is settled. If the price of wheat futures is still at $4.00 the farmer will have made $1000 on the futures contract and the baker will have lost the same amount. However, the baker now buys wheat on the open market at $4.00 a bushel - $1000 less than the original contract, so the amount he lost on the futures contract is made up by the cheaper cost of wheat. Similarly, the farmer must sell his wheat on the open market for $4.00 a bushel, less than what he anticipated when entering the futures contract, but the profit generated by the futures contract makes up the difference.

The baker, however, is still in effect buying the wheat at $5.00 a bushel, and if he hadn't entered into a futures contract he would have been able to buy wheat at $4.00 a bushel. He protected himself against rising prices but he loses if the market price drops.

Speculators hope to profit by the daily fluctuations in the futures market by buying long (from the buyer) if they expect prices to rise or by buying short (from the seller) if they expect prices to fall.

FOREX

The foreign exchange market (FOREX) has several advantages over the futures market. FOREX is a more liquid market – as the largest financial market in the world it dwarfs the futures market in daily exchanges. This means that stop orders can be executed more easily and with less slippage in the FOREX.

The FOREX is open 24 hours a day, 5 days a week. Most futures exchanges are open 7 hours a day. This makes FOREX more liquid and allows FOREX traders to take advantage of trading opportunities as they arise rather than waiting for the market to open.

FOREX transactions are commission-free. Brokers earn money by setting a spread – the difference between what a currency can be bought at and what it can be sold at. In contrast, traders must pay a commission or brokerage fee for each futures transaction they enter into.

Because of the high volume of trading FOREX transactions are almost instantly executed. This minimizes slippage and increases price certainty. Brokers in the futures market often quote prices reflecting the last trade – not necessarily the price of your transaction.

The FOREX is less risky than the futures market because of built-in safeguards in the trading system. Debits in futures are always a possiblility because of market gap and slippage.