

Cocoa Futures & Options: Are They a Good Fit for the Industry?



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Futures and Options Trading



Futures Exchanges are many things to many people:

For nearly everyone that trades cocoa, the Exchange is a barometer of market values, reliably measuring the net consensus of world cocoa knowledge and opinion.

To people in the cocoa industry, it is a hedging medium in which sales can be made to offset the risk of stock ownership, or in which coverage can be bought against forward sales. It is also an alternative market in which to price cocoa when futures offer an alternative basis compared to “actuals” in the spot or shipment positions.

To those who wish to take risk a long or short position, the Exchanges are the ideal trading media, for they offer complete assurance of contract fulfillment and a broad continuous market in which positions can be taken or undone at a moment’s notice usually within reasonable price limits. One lot traders or multi-contract positions enjoy equal opportunity to meet an attractive bid.

To banks, the Exchanges are the means by which cocoa beans become superior loan collateral. It enables them to finance world cocoa stocks in virtually unlimited quantities.

Who's the New Kid on the Block?



Trading in cocoa arose after there was a demonstrated need for this with the history back to WW1 and a boom from speculative fever which burst in 1921. The New York Cocoa Exchange was formed in 1925 and is now part of the Intercontinental Exchange (ICE)

The London Terminal market has a parallel history founded in 1928. With the outbreak of war in 1939, trading ceased with controls lasting until 1950 and the market reopened in January 1951. The London contract is now owned by ICE Europe

While the ownership and trading platform has changed, aside from some modifications in some rules and delivery terms, the contracts are still fairly much the same as when they were first introduced decades ago.

The CME group introduced a physically delivered, euro-denominated cocoa contract aimed at improving cash market price convergence. They also launched a US dollar denominated, cash settled cocoa futures contract to enable margin offsets and arbitrage between the London and New York cocoa markets. The first listed month was July 2015 and began trading in March.

Options on the euro based contract has also been launched and the first listed month is September 2015.

ICE launched a competing euro based contract.

CME Cocoa Contracts



According to the CME, the new Physically Delivered Cocoa futures contract responds to demand from the cocoa market for an improved hedging mechanism that better reflects the underlying physical cocoa market and includes pre-payment of delivery-out charges enabling better convergence between futures and cash markets. At the same time having the new cash futures dollar based contracts offers reduced margin and arbitrage opportunities.

Other features:

Electronic depository to manage warehouse warrants cost effectively

Contracts priced against bulk and bagged cocoa

Grading based on Federation of Cocoa Commerce Ltd (FCC) standards

CME Group and SGS New Grading Facility



A new state-of-the-art cocoa grading facility is now in Amsterdam, one of the three deliverable ports for the new cocoa futures contracts.

By bringing grading closer to the delivery port, CME Europe hopes to improve the efficiency and cost effectiveness of the futures sampling and grading process and partnering with SGS helps to ensure the integrity of the process.

The grading facility offers high quality services and fast turnaround times

Most New Contract Launches are Doomed



The success of a new contract, especially a competing contract is rare even with full commercial industry support.

The speculative community including funds needs to be active participants to provide the necessary liquidity for success.

Old habits die hard. Commercial traders will still gravitate to the volume and larger markets unless specifically noted/requested.

Too many contracts can also add confusion and water down the open interest in all the contracts, creating further problems.

Cocoa Contract Liquidity Comparison



September 11	ICE New York	ICE London Sterling	ICE Euro	CME Financial Future	CME Euro
Total Volume	20,190	26,141	0	0	79
EFP	345	8,316	0	0	0
Spreads	8,612	10,556	0	0	0
Open Interest (Sep 10)	190,319	278,295	52	0	977



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