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A “MINI” PRIMER

By Mike Paulenoff, MPTrader.com

One morning in mid-November with the market having sold off for three straight days, a friend of ours, Bill, decided to bet the market would rally. Rather than buy the cash index (i.e., through funds or ETFs that track the S&P 500), Bill decided to trade the index futures, where he has far more margin power and where nearly round-the-clock trading enables him to buy before the open of the cash market. His early morning price was 1041.50, or, as it turned out, 5 points below the S&P 500's opening price.

Bill bought the E-mini S&P contract rather than the regular S&P index contract. The E-mini is 1/5 the contract size and requires far less money down on margin. A single regular S&P contract, which is valued at \$250 per point (or about \$260,000 on a 1041.50 price), requires about \$20,000 in margin. An E-mini contract, valued at \$50 per point, requires about \$4,000 – and that's if you're holding overnight. If you're day-trading, as Bill was, you can buy up to 49 E-mini contracts on just \$500 margin using Global Futures Exchange.

Bill bought 10 December E-mini S&P contracts, and, at the same time, entered an intraday protective stop on his E-mini position to limit his loss in case his analysis and entry proved ill-timed or faulty. By evening, with the December E-mini S&P up to over 1059.75 (.25 points higher than the cash index's close), Bill was able to sell the contracts at more than 18 points. That's 18 times \$50 per point times 10 contracts...or \$9,000.

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The above example is not aimed at enticing you to run out and start blindly trading E-minis. Rather, it is meant to provide a simple illustration of how E-minis are traded and why they've become such popular trading instruments.

Introduced by the Chicago Mercantile Exchange in 1997, today the E-mini equity index product suite includes the E-mini S&P 500, E-mini NASDAQ-100 and the E-mini Russell 2000. These smaller-sized products traded a staggering 171,092,756 million contracts in 2002 and 58,126,634 million contracts in the first quarter of 2003, making them the fastest growing products in CME history at an average of 130% over the past three years.

I use the E-minis (preferring to focus on the S&P and Nasdaq rather than Russell) both as a trading instrument and a gauge for determining market direction. As a trading instrument, the example of Bill's trading experience illustrates how E-minis can be profitable. As a market gauge, the sheer volume of trading makes it an ideal tool for studying how traders are viewing the broader indices.

More than 139 million E-mini S&P 500 contracts were traded in the first 10 months of 2003, compared to just under 17 million of the big S&P 500 contracts. On the Nasdaq side, the ratio was 56.9 million for the mini versus 3.7 million for the large contract. Given the volume, along with the virtually round-the-clock trading (pausing for just a half hour between 4:15 and 4:45 pm Eastern during the week, and between 4:15 pm Friday and 6:30 pm Sunday on weekends), E-mini futures can impact and anticipate the movement of the cash equity indices. Thus, people investing in stocks or funds that track the S&P 500 or Nasdaq 100 may do well to follow the E-minis.

E-minis trade on the CME's GLOBEX electronic trading platform, which is accessible to traders either directly through a CME-certified front-end system or through a futures broker online or by phone. The symbols vary by quote system, but on the CME's system they are ES for the E-mini S&P and NQ for E-mini Nasdaq – plus a letter for the expiration month (i.e., NQZ for December).

The minimum price movement of the S&P E-mini contract, called a tick, is .25 index points, or \$12.50 per contract. If the futures contract moves the minimum price increment (one tick), say, from 1040 to 1040.25, a long position would be credited \$12.50 and a short position would be debited \$12.50. Brokerage accounts are adjusted nightly to reflect unrealized gains and losses, and if accounts drop below the minimum margin requirement, brokers can issue a “margin call,” closing out positions and requiring the deposit of additional money to continue trading.

Hence the difference in margin requirements between a day-trading position and a position held overnight, as we noted in the example of Bill. Overnight trades carry far more risk. Margin levels in futures trading are set by the exchanges (the CME in the case of the E-mini), which adjust the levels to encourage or discourage trading depending on level of activity and volatility. However, the clearing firms have the option to increase marginal requirements beyond the level set by the exchanges, depending on how much, or how little, risk they want to assume for themselves and their customers.

To help traders minimize the risks – and improve on the rewards – technicians like myself spend a lot of time studying the technical charts of the E-minis. We look at the price patterns from different timeframes (I use, for example, 15-minute charts for intraday analysis, hourly charts for near-term 1-2 day analysis, and daily charts for 1-2 weeks); we identify price support and resistance levels and where the prices are at relative to these levels as well as to moving averages; and we assess all that in relation to the indicators such as volume intensity, relative strength and stochastics.

As anyone who follows my work knows, I look for what I consider to be a high-probability directional outcome to a particular stock index trade as well as multiple target windows that enable traders to profit from entering the market. I am more interested in these target windows, or zones, than specific prices as they allow my subscribers to be active -- if not interactive -- participants in the process of experiencing a move from point "a" to point "b." This gives them the opportunity to exit or enter a position in a range rather than at a specified price.

Those interested in observing my methodology first-hand can try my E-Mini Diary free for 30 days at www.mptrader.com. For more information on E-minis in general, I recommend visiting the CME's at www.cme.com. For real-time charting of E-minis, I use Qcharts (www.qcharts.com) and CQG (www.cqg.com), and for futures brokerage, two firms I like are Dorman Direct (www.dormantrading.com) and Global Futures Exchange (www.gfetc.com).

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