Investor Guide

PAKISTAN MERCANTILE EXCHANGE

PMEX

Your Futures Exchange, the Exchange of the Future

Contents

Introduction

Pakistan Mercantile Exchange Limited (PMEX) is Pakistan's first and only multi-commodity futures exchange, which is licensed and regulated by the Securities & Exchange Commission of Pakistan (SECP). Its shareholders include National Bank of Pakistan (NBP), Pakistan Stock Exchange Limited (PSX), ISE Towers REIT Management Company Limited, LSE Financial Services Limited, Pak Brunei Investment Company Limited, Zarai Taraqiati Bank Limited and Pak Kuwait Investment Company Limited. The Exchange offers a diverse range of domestic and international commodities and financial futures. With a sophisticated infrastructure based on state-of-the-art technology, PMEX provides a complete suite of services i.e. trading, clearing and settlement, custody as well as back office, all under one roof. PMEX's international affiliations include Memberships of Association of Futures Markets (AFM), Hungary & Futures Industry Association (FIA), USA and Memorandum of Understanding (MoUs) with Borsa Istanbul, Izmir Commodity Exchange, Dubai Gold & Commodity Exchange (DGCX) and Iran Mercantile Exchange (IME).

PMEX Products Suite

PMEX offers products that cater to the needs of all types of market participants such as investors who invest in commodities for long term, traders who work with the aim of earning profit based on their market strategy and hedgers who trade to mitigate their risk, using commodity futures market.

There are 2 types of contracts Listed at PMEX.

1. **Deliverable Contract:** This is a contract which is settled through giving/taking the actual delivery of the underlying commodity on final settlement after the expiry day. However the investor/trader has the right to square off his/her open positions at any time before expiry and book profit/losses in term of cash.

2. **Cash Settled Contract:** There is no obligation of giving/taking deliveries of underlying commodities after the expiry of contracts. The profit/loss transferred into the respective traders accounts on final settlement day if their positions remained open on expiry. However the investor/trader has the right to square off his/her open positions at any time before expiry and book profit/losses in term of cash.

At present, the Exchange offers 23 commodities with 41 contracts of different denominations which can be clubbed into four main asset classes: metal, agriculture, energy and financial futures. Namely, these are: Gold, Oil (Brent & WTI), Silver, Copper, Platinum, Natural Gas, FX Pairs, US Equity Indices, Red Chilli, Paddy Rice and Wheat.

Products	Contracts	
	Deliverable	Cash Settled
Metals	Mini Gold Contract Tola Gold Contract Milli Tola Gold Contract	Gold 100 gram Contract Gold Kilo Contract Gold 50 & 100 Tola Gold (1, 10 & 100 oz) US $ denominated Silver (5,000, 500, 100 &10 oz) US $ denominated Milli Ounce Gold Contracts in EUR, GBP, JPY, CAD, AUD, CHF Copper (1,000 & 25,000 pounds) US $ denominated Platinum (5 & 50 oz) US $ denominated
Energy		Crude Oil (10, 100 & 1,000 barrels) US $ denominated Brent Crude Oil (10, 100 & 1,000 barrels) US $ denominated Natural Gas (1,000 & 10,000 mmbtu) US $ denominated
Agricultural	IRRI-6 Rice Futures Contract Weekly IRRI-6 Futures Contract Palm Olein Futures Contract Sugar Wheat Paddy Rice Red Chilli	I-Cotton (5,000 & 50,000 pounds) US $ Denominated
Financial		US Equity Indices (PMEX US Equity NSDQ 100 Index, PMEX US Equity Industrial Index & PMEX US Equity 500 Index futures contracts) KIBOR Futures Contract

PMEX Milli Tola Gold

In December 2013, PMEX launched 'Milli Tola Gold', a product aimed at all income strata with special emphasis on low income groups and savers, who are seeking a convenient, secure and trusted way to buy, sell and accumulate gold as savings. Milli Tola, as the name suggests, represents 1/1000th part of a Tola which can be bought in multiple of approx. Rs 50.

Following are the salient features of the product:

- **Start from little**: Buy Gold with an amount as low as approx. Rs50
- **Incentive:** Free of cost custody/Free Insurance
- **Security:** Gold is kept in secure vaults
- **Convenience:** Hassle free buying and selling of gold from anywhere with a single click
- **Liquid**: Easily en-cashable within 24 hours
- **Physical delivery:** If required, you may withdraw gold from PMEX
- **Monitoring:** SMS Alerts of all transactions are sent by PMEX
- **Purity:** Authentic 24karat (99.90%) Gold
- **Transparency:** Price is fair and efficient

PMEX Milli Ounce Gold Futures Contracts

PMEX is in a continuous pursuit to add new products to broaden its product suite in order to cater to the needs of a diversified group of investors. Previously, the Exchange has listed various gold contracts in different denomination and tenor.

However, keeping in view the demand of the market participants, the Exchange listed "Milli Ounce Gold" futures contracts. At present, the Exchange offers trading in 16 futures contracts of FX pairs namely: EUR/USD, AUD/USD, GBP/USD, USD/CHF, USD/CAD, USD/JPY, EUR/GBP, EUR/JPY, EUR/CHF, EUR/CAD, EUR/AUD, AUD/JPY, CHF/JPY, GBP/CHF, GBP/JPY, AUD/CAD.

These contracts use "Composite Order Trading System" (COTS) where a trader may take two positions simultaneously in milli ounce contracts with a single click. In other words, if a trader wants to simultaneously take a long position in the PMEX USD Gold and short position in the PMEX AUD Gold, he can place a single order through COTS. The long gold in the first trade and the short gold in the second trade 'cancels' each other out, leaving the trader with an open AUD-USD position only.

Trading Of Red Chilli At PMEX

Red Chilli is a potent ingredient in various cuisines around the world. It is produced seasonally but consumed throughout the year. Pakistan continues to remain among the top five producers in the world. The varieties grown in Pakistan are of high quality and superior to other varieties grown in the region.

In Pakistan, Sindh is the largest producer of red chilli with annual production at 85,000 tons' which amounts to 85% of the country's produce. The production pf red chilli is concentrated in the small town of Kunri, also known as the 'Chilli Capital of Asia", located in Umarkot, a district of Sindh province. Other cultivation hubs in Sindh are Mirpur Khas, Sanghar, Badin, Tando Muhammad Khan, Khairpur, Shikarpur, and Ghotki.

Historically in Pakistan, Red Chilli production and its prices have remained highly volatile due to the lack of dependable storage facilities and credible trading platforms. Often growers are forced to sell their produce at lower price where the middle men would remain the key beneficiary, taking away a major chunk of the sellers' margins.

PMEX remains committed to playing its due role in the development of a robust and sustainable ecosystem for commodity trading that can free the growers from the shekels of traditional trading system and enable them to get premium on superior quality produce and guaranteed prompt payment.

With continued perseverance and support of Securities and Exchange Commission of Pakistan (SECP) and value chain partners, PMEX has been successful in developing a workable model for trading physical commodities and has launched deliverable Red Chilli in 2015. In this respect the Exchange worked with the following partners:

- SGS Pakistan for quality certification
- Agility Pakistan for warehousing and logistics
- Pakistan Agriculture Collation for on-ground farmer facilitation

At present, PMEX offers weekly and longer dated futures contracts of Dandicut/Long and Hybrid varieties of red chill at its electronic trading platform. The Exchange has received an encouraging response from all the market participants for the efforts that resulted in better quality red chilli production, quick cash pay-out to the farmers and overall efficiency in the red chilli trade. .

Though it was the first ever listing of a spice at the Exchange, the concerted efforts of all the market participants i.e. growers, traders and corporate buyers enabled PMEX to achieve this milestone. In FY2016-17, the trade of Red Chilli at the Exchange surged to 2,200 tons from 600 tons as compared to previous year.

The quantum jump in the traded volume is attributed to various initiatives the Exchange undertook during the span of two years. Firstly, PMEX made rigorous efforts to increase awareness and improve participation of buyers and sellers at its trading platform. Several awareness programs and roadshows were organized in Kunri, Faisalabad and Karachi prior to the arrival of crop of 2016 and 2017. The programs were aimed at creating awareness among the farmers and traders about the benefits of trading at a PMEX's technology driven platform. Besides, the programs also highlighted the facility of acquiring credit from the financial institutions against stock of Red Chilli kept at PMEX designated warehouses. These programs brought together market participants and value chain partners under one roof and provided a platform to the farmers and traders to explore the opportunities associated with trading of Red Chilli at PMEX.

Secondly, having persuaded the growers and traders to actively trade Red Chilli at its trading platform, PMEX was also successful in bringing on board the Sindh Enterprise Development Fund (SEDF), Sindh Board of Investment to offer subsidy to Red Chilli growers to bring down the cost of trading.

Lastly, the Exchange achieved another milestone by arranging commodity based financing for the first time in the country for agri products kept at its designated warehouse for trading. The Exchange brought on board Habib Bank Limited (HBL) and Zarai Taraqiati Bank Limited (ZTBL) to extend loans against the commodity as collateral whereas the historical mode of financing has primarily been based on passbook/land papers.

Going forward, the Exchange plans to offer its physical deliverable commodity trading platform to the international market thereby enabling foreign buyers to buy local commodities such as Red Chilli, Rice, etc. with convenience of trading and confidence of quality assured produce as per international standards.

PMEX Shariah Compliant Trading Platform

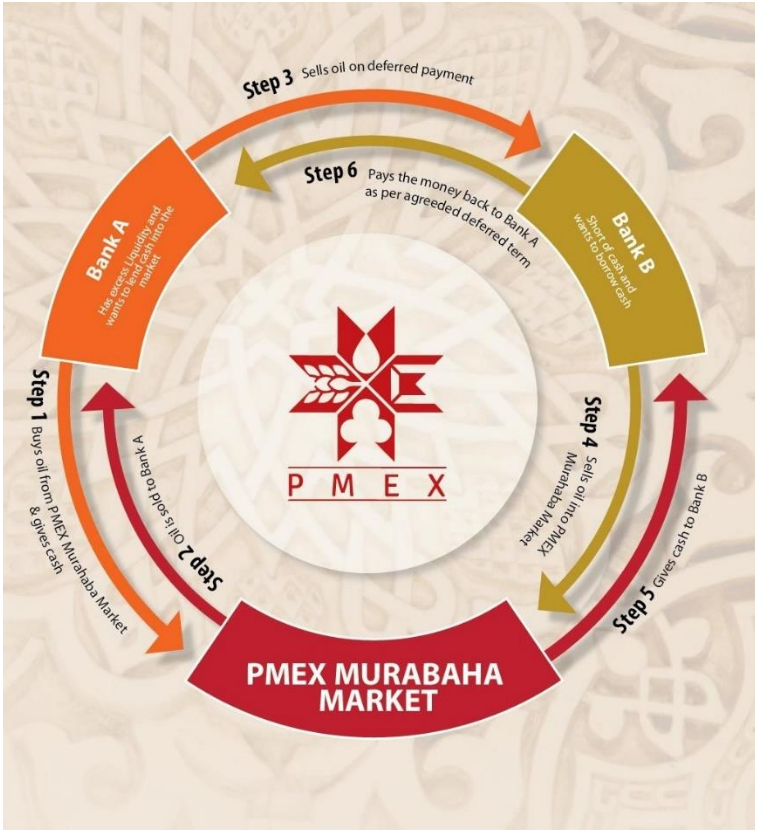
In Pakistan, Islamic banking is growing at the rate of over 30 percent annually and its asset base has crossed PKR 1 trillion. However, such a significant growth has created surplus liquidity in the Islamic Finance industry. While deposits are on the increase, Islamic Financial Institutions (IFIs) have limited lending/investment options, there is an acute shortage of Islamic money market related instruments which are necessary to efficiently deploy the liquidity being generated due to increase in deposits. Although these IFIs have developed certain means by which the liquidity is currently being managed, there is no standardized product available to completely and efficiently meet the need of the industry. Considering the above, IFIs are looking for more trustworthy and efficient ways for conducting such transactions.

In the light of the above, Pakistan Mercantile Exchange (PMEX), under the able guidance of State Bank of Pakistan (SBP), Securities, Exchange Commission of Pakistan (SECP) and Sharia Advisory Board of Meezan Bank, has taken the initiative to develop PMEX Shariah Compliant Trading Platform (SCTP). Through this platform, IFIs will be able to execute commodity Murabaha transactions in a convenient, transparent and Shariah complaint manner.

PMEX SCTP is in line with the platforms offered by international commodity exchanges such as London Metal Exchange, Bursa Malaysia and Jakarta Futures Exchange, which are also enabling Murabaha transactions and are acting as hubs for Islamic Banking liquidity management.

With the assistance of the Sharia Advisor, PMEX lead multiple discussions with financial institutions and industry stakeholders and concluded that High Speed Diesel (HSD) would be the ideal underlying asset for the commodity Murabaha transactions at PMEX SCTP. The product meets key requirements of Sharia i.e. abundant supply, non-perishable nature, adequate infrastructure for the storage and handling, sold by all the OMCs operating in the country and certified quality standards of the product. Moreover, the price determination of the product is fixed by competent authority.

PMEX has been encouraged by the keen interest and enthusiasm shown by the IFIs in the SCTP and is confident that this landmark initiative would strengthen the Islamic financial sector and eventually serve as an industry benchmark and be the first choice for the IFIs.



Market Timings

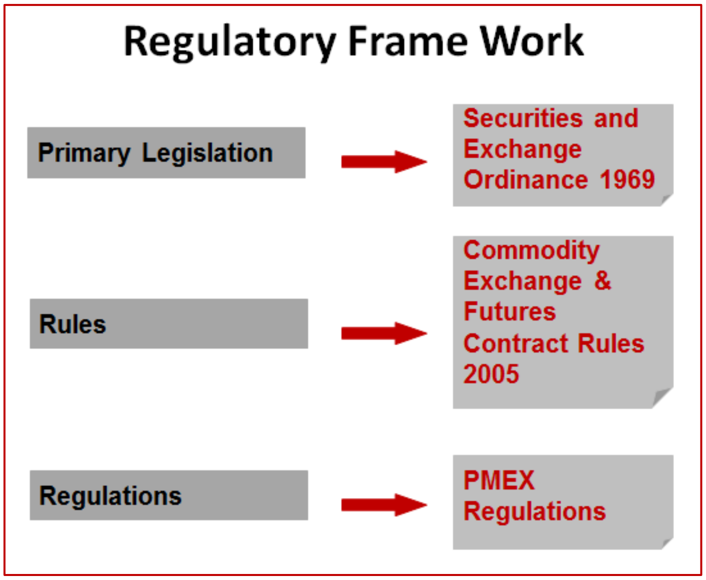
Current market timings of the Exchange are:

Monday: 3 am to 2 am (23 hours)
Tuesday – Friday: 5 am to 2 am (21 hours)

To facilitate PMEX clients, Customer Support Services (CSS) are available five days a week throughout the trading hours. To contact our CSS, call at 021-111-623-623, 0300-8213-324 and 0321-8756-623 or email at support@pmex.com.pk.

Regulatory Framework

At PMEX, a comprehensive regulatory framework has been put in place to protect the interest of all the stakeholders. This framework comprises of three layers:



Regulator

The apex regulator of PMEX is the Securities & Exchange Commission of Pakistan (SECP).

SECP is the financial regulatory agency in Pakistan whose objective is to develop a modern and efficient corporate sector and a capital market based on sound regulatory principles, in order to encourage investment and foster economic growth and prosperity in Pakistan. To learn more, visit http://www.secp.gov.pk/

Trading Systems at PMEX

NEXT Trading Terminal

NEXT is a web based trading terminal that enables PMEX Brokers and Traders to buy and sell commodities online.

Features:

- Market Watch (live rates)
- Buy (Order Types: Market, Limit, Stop Loss Limit, Stop Loss Market, Trailing Stop Market)
- Sell (Order Types: Market, Limit, Stop Loss Limit, Stop Loss Market, Trailing Stop Market)
- Market By Price (MBP)
- Working Order (As placed by different Order types)
- Position (Position summary)
- Message Window (Actions performed, Exchange Alerts)
- News Window (Exchange Alerts)
- Reports (Client Portal, News Wire, Order Details, Message Logs, Risk Watch, Trade Details, Position Details, Chat, Economic Calendar)
- Profile (Contract Profiles, Change Password)

Trader Account Management System (TAMS)

Trader Account Management System is used to perform the following functions:

UIN (Unique Identification Number) Management	Trader Management	User Management
• UIN Entry • Unfreeze UIN • Freeze UIN • UIN Information	• Assigning specific commodities • Assigning commodity limits • Increasing margins • Suspending a trader • Setting Trader Threshold	• Add User • Edit Pending • Edit User • Assign Traders • Activate User • Suspend User • View User Log • Re-Issue USB Key • Pending Re-Issue USB Requests • Add KATS Id

Clearing, Settlement, Reporting (CSR) System

CSR is an in-house developed, web-based back office system that enables PMEX members to manage clients' clearing and settlement needs with high degree of efficiency and generate comprehensive reports. It has an easy-to-use user interface. This service is offered free of cost to PMEX members.

Daily Operations	Setup	Market Information	Operation Reports	Surveillance Report
• Funds Management (Funds allocation, Funds Withdrawal, Funds Transfer and Approval, Securities Release) • Commission Management (Commission Upload and Download) • Gold Management (Gold Withdrawal, Delivery, Receipt)	• Bank Account Management (Bank Account Numbers, Primary Bank Accounts) • Key Personnel Setup	• Session Management (Session Market Price, Session History, Spread Market Price) • Contract Reports • Margins Reports • Commodity Reports • MGold Market Prices • MGold Session Prices • MGold Contracts	• General Ledger • Trader Funds • MiniGold Receipts Trader Vault Transactions • Settlement Call • MGold Trader Margin • MGold Daily Settlement • MGold Withdrawal Request Status • Key Personnel Details • Broker Exposure Client Wise • Trader Balance	• Trade Details • Position Summery • Account Statement • Daily Statement • Client Margin Call • Ticket Trade Details • MGold Trade • Vault Positions • MGold Positions • Order Details • Account Statement History • Daily Statement History

eBooks

While the rest of the systems are offered free of cost to clients, PMEX eBooks is a paid service offering a tailored solution that encompasses all the requirements including accounting at company and branch levels with additional features such as user role definition and access control, commodity/client specific commissions, general ledger and synchronization with PMEX CSR System.

Membership

PMEX Offers two types of memberships:

Universal Membership:

Universal members are entitled to trade in all futures contracts across all asset classes listed on the Exchange.

Commodity Specific Membership:

Commodity Specific Members are allowed to trade in all futures contracts in a particular commodity.

PMEX Brokers

A commodity broker is a firm or an individual who executes orders to buy or sell commodity contracts on behalf of clients and charges them a commission.

PMEX has over 300 members out of which currently 118 are eligible to trade & registered with SECP. To access complete list of registered brokers, visit http://www.pmex.com.pk/investor/registered-broker.php.

How to open an account with the broker

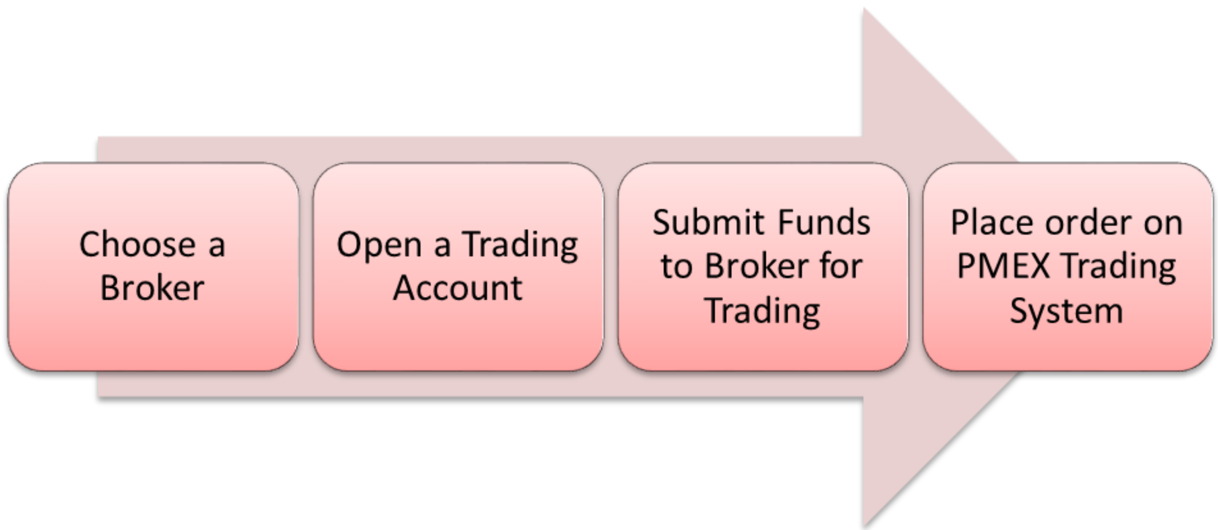
- Fill out the PMEX prescribed Account Opening Form
- Carefully read and sign the Risk Disclosure Document
- Provide the basic KYC details

Individuals	Companies and Firms
• Date of birth • Gender • Address • Phone No. • Email • CNIC • Occupation • Annual income in last 3 years	• Board Resolution • Certificate of Incorporation • Date of business commencement • National Tax number • Sales tax registration number

Trading At PMEX

Any person or a body corporate who wants to trade on the exchange platform needs to approach a member broker of PMEX to open a trading account. Once the account is opened and funds [margins] are made available, clients can trade at their own convenience via the Exchange's web based trading platform.

Steps of Trading at PMEX



Benefits of Trading At PMEX

Market Transparency:

Ensured through electronic matching of bids and offers based on price-time priority, using advanced technology and systems especially created for today's commodity markets.

Global Prices:

Prices of International commodities traded at the Exchange are referenced to global exchanges.

Price Discovery:

For Local commodities traded in large quantities.

Counterparty Guarantee:

Clearing and settlement is guaranteed through an in-house, regulated clearing house.

Risk Management:

Robust risk management framework based on international best practices.

Time Zone Convenience:

21 hour seamless environment thereby providing trading opportunities virtually round-the-clock.

Multiple Connectivity Options:

The trading platform can be accessed through the internet using one of the following options:

1- The in-house front-end provided by PMEX i.e. NEXT

2- Financial Information Exchange [FIX] connectivity for third party software.

Guidelines for Brokers and their Clients

The commodity futures market in Pakistan has witnessed rapid growth since 2007. During the last 10 years, there have been regulatory, structural and operational changes in the commodity futures market. The objective of these changes is to bring efficiency, enhance transparency, prevent unfair trade practices and align Pakistan's commodity futures market with international best practices.

To achieve the above objective, PMEX, a Self-Regulatory Organization (SRO), has prescribed guidelines for its Brokers and their clients.

Guidelines for PMEX Brokers

DO'S	DON'TS
1. Always enter correct registration details of clients on Exchange Trading System 2. Issue confirmations for trades executed on behalf of clients within 24 hours and obtain acknowledgment thereof 3. Ensure that all requisite signed documents have been received from clients including Account Opening Form, Risk Disclosure Document and Discretionary Trading Authority (where applicable) 4. Maintain proper records of registered offices, authorized persons, branches and clients 5. Ensure that investor grievance redressal mechanism is in place at all dealing locations such as head office and branches 6. Ensure that all authorized persons and branches are registered with the Exchange 7. Ensure that a list of commodity futures contracts that are permitted & traded at the Exchange has been prominently displayed at the head/branch offices 8. Ensure that the authorized persons/branches are following and complying with all the relevant provisions of the rules, regulations, circulars or directives issued by the Exchange and Securities & Exchange Commission of Pakistan (SECP) 9. Ensure that employees/authorized person only receive payments in the form of banking instruments in the name of the broker 10. Ensure that name of broker, registration number and certificate of registration of authorized person along with terms and conditions of branch dealing has been displayed at the registered branches 11. Always include the disclaimer specified by the Exchange while making any advertisement 12. Ensure that advertisement made by the branch/authorized person should have the approval of the broker 13. Notify change of the authorized person to the Exchange at least 15 days before the change 14. Conduct periodic inspection of the authorized	1. Do not execute trade in client's account without explicit written authority or instructions as per Exchange or SECP provided guidelines 2. Do not alter or change terms and conditions of Standardized Account Opening Form (SAOF). Any additional terms and conditions shall not contradict with the terms and conditions of SAOF 3. Do not utilize or invest funds of clients beyond the scope of PMEX and related activities 4. Do not obtain any blank document or blank cheque from client 5. Do not deal in cash with clients over and above the prescribed limit of Rs. 25,000. Moreover, cash dealing is only permitted in exceptional circumstances 6. Do not enter any wrong, contradictory or incomplete information on Exchange Trading System 7. Do not attract clients by alluring advertisements, rumors, hot tips or the promise of assured returns 8. Do not misuse discretionary authority given by the clients for churning / generating commission 9. Do not obtain client's personal id and password. In case of discretionary authority, always trade through member login credentials

persons/branches 15. Upon noticing any irregularities in the branch operations, immediately correct or deregister the authorized person or branch 16. Be vigilant about any fraudulent activity of employees and authorized persons 17. Approach PMEX in case of any clarification required on compliance related issues	

Guidelines for the Clients of PMEX Brokers

DO'S	DON'TS
18. Verify the authenticity of a Broker and its branches from the list of registered brokers from PMEX website (http://www.pmex.com.pk/investor/registered-broker.php.) 19. Carefully read and understand the terms & conditions along-with Risk Disclosure Document 20. Ensure that all information is accurately filled in the Account Opening Form and a signed copy of the form is retained for future reference 21. In case of Discretionary Trading Authority given to Broker, ensure thorough review of the Discretionary Trading Guidelines available on the website of PMEX 22. Ask your Broker to activate your login credentials 23. Only make payments through banking channel (online banking, cross cheque, pay order, etc. in the name of the Broker) and obtain payment receipt 24. Verify that payments are allocated in your trading account maintained by the Broker in PMEX 25. Ensure that Broker sends daily, weekly, monthly account balance & activity statements to know the trade activity & cash balances in the trading account 26. Ensure that Broker sends SMS alerts for trades and cash movement in the trading account 27. Approach PMEX in case of any complaint that remains unresolved by the Broker	1. Do not deal with Brokers or their branches not registered with PMEX 2. Do not give wrong, contradictory or incomplete information in the Account Opening Form. 3. Do not issue cross cheque, pay order, demand draft in the name of any authorized representatives of the Broker 4. Do not deal in cash with any Broker or their authorized representatives over and above the prescribed limit of Rs. 25,000. 5. Do not get misled by alluring advertisements, rumors, hot tips or the promises of assured returns by the Brokers or their authorized representatives 6. Do not give discretionary authority to Brokers to make 'sale' and 'purchase' decisions without understanding the associated risks 7. Do not share personal id and password provided by the Exchange with the Brokers or their authorized representatives 8. Do not surrender the right of receiving cash & trade balances reports via email and SMS 9. Do not start trading before reading and understanding the Risk Disclosure Document provided by PMEX

Risk Management

At PMEX, risk management philosophy is based on applying best international practices to local conditions. The methodologies employed at the Exchange are proactive in nature and designed to strike an efficient balance between prudence and reality.

The risk management framework has stood up well since inception and even during periods of high market volatility and turmoil. In addition, the Exchange continuously undertakes original research in order to further improve the existing practices. Measures like pre-trade checks, client-level margining, no-netting, segregation of funds, auto-liquidation and multiple intraday mark-to-market ensure a robust risk management framework at the Exchange.

Research

PMEX believes in educating the investors and considers it an utmost priority. In line with this, the Exchange develops and disseminates comprehensive commodity reports on a daily, monthly and yearly basis. These free of cost reports provide PMEX clients with a well-rounded and diversified overview of the commodity market.

In addition, the Exchange has a dedicated section on its website, whereby Commodity Roundups are updated on a daily basis. This section also provides a platform to other brokerage houses to showcase their reports.

Training

PMEX offers Futures Trading 101, biweekly free of cost training sessions, scheduled every Tuesday and Thursday from 3:00 pm to 5:00 pm at PMEX premises. The training is specially designed for market participants to provide an in-depth knowledge of commodity fundamentals, technical analysis and listed products at PMEX.

In addition, it also equips trainees with hands on experience with the Trading System at PMEX. To register, log on to www.pmex.com.pk

12 Cardinal Mistakes of Commodity Trading

The following excerpt is taken from an article titled "12 Cardinal Mistakes of Commodity Trading" written by Walter Bressert.

1. Taking small profits and letting your losses run

A very common mistake among futures traders is taking small profits and letting losses run. This is often the result of no game plan. After one or two losing trades, you are very likely to take a small profit on the next trade even though that trade could have turned into a large profit-maker that would offset all your losses. Letting your losses run often happens to new futures traders and is not uncommon among professional futures traders. After entering a market, you don't know where to get out. Once you start losing money your tendency is to let your loss get larger and larger as you hope that the market will retrace to let you break even — which of course, it seldom does.

This mistake is overcome by using predetermined stop/loss orders to prevent your losses from running, and following your game plan to take profits at your profit objective.

2. Overstaying your position

One of the most common mistakes of trading futures is overstaying your position, or simply failing to take profits at a predetermined level. There seems to be a natural law that the market is only going to allow one individual so much money before it starts to take it back. Yet, it is when you have these profits, especially paper profits in your account that you often try to get the last nickel out of the trade.

If the market meets your price objective and you are still in the market without a close stop/loss order, you are overstaying your position. All too often the market breaks sharply through your "mental stop" and from that price level, you watch your paper profits disappear before your eyes. Then you decide to hold on for a small rally, and the market never rallies enough. It drops back to break-even, and now you really begin hoping. Next thing you know you have a loss. Be aware that a large profit can turn into an even larger loss.

This mistake can be overcome by the use of trailing stops raised closer to the market as your price objective is approached, or automatically taking profits at your price objectives.

3. Averaging a loss

This is usually a holdover from trading stocks. In futures, with five or ten percent margin, averaging a loss can be disastrous to say the least. A typical approach is that after you have bought a future and it drops lower, you might figure that since it was a good buy then, it is a better buy now. You can also justify averaging down by figuring you will have a lower average entry price and require a smaller move to break even. Unfortunately, you will lose twice as much if the market continues against you, as it almost always does.

There are approaches that will allow you to buy a market at one price level, add on at a lower level and add on again at even a lower level, as long as this was your predetermined game plan before you bought the first contract. You must also have an unmovable stop/loss order that takes you out of all contracts.

This mistake is easily overcome by having a strict rule that you never average a loss unless your predetermined game plan called for buying the market at lower levels with an unmovable stop/loss order to take you out of all contracts if it is hit.

4. Lack of a game plan

90% of the commodities traders have no game plan. That means they do not know what to do if they are wrong and they do not know what to do if they are right. The large paper profit they made often turns into a large loss because they did not know where to get out.

One of the most important moves a futures trader can make is to develop a game plan consisting of these basic guidelines.

- Know how and where you are going to enter a market.
- Know how much money you are going to risk on each and every trade.
- Know how and where you are going to get out if you are wrong.
- Know how and where you are going to take profits if you are right.
- Know how much money you are going to make if you are right.
- Have a Safety Stop in case the market does the unexpected.
- Have an approximate idea of when a market should meet your objectives; when it should begin to make a move, and if it has not done so, get out!

5. Lack of money management

Many commodity traders refer to a trade that might lose them $500 if they are wrong and make them $1500 if they are right as a three-to-one risk/reward ratio – a “decent” trade. Yet, that is wrong because the most important aspect of a trade is not how much you are going to lose if you are wrong, or how much you are going to make if you are right, but what are the odds of making money, of being right. What are your odds of losing money, of being wrong?

Good money management means you know your profit objective and the odds of being right or wrong, and control your risk with stops. You are better off with a trade where you might lose $1000 if you are wrong, or make $1000 if you are right, that would work eight times out of ten, than to take a trade where you would make $1500 if you are right and lose only $500 if you are wrong, but works only one time out of three.

Obviously, this mistake can be overcome only by developing and testing money management concepts.

6. Failure to use protective stop/loss orders

This fits right in with a game plan and money management. It is the failure to use stop/loss orders once you enter a market — not mental stops, but real stops that cannot be removed. All too often commodity traders use mental stops because in the past they have been stopped out and then watched the market move in their direction. This does not invalidate the use of stops, it means their stop was in the wrong place — they did not have a good technical stop.

When a stop/loss order that was determined before you entered the market is hit, it means your analysis was wrong, your game plan was wrong. With a mental stop, as soon as the market has gone through your stop price, you no longer act like a rational human being. You are more likely to make mistakes because you are now operating on fear and hope.

There is an old saying that the first loss is the smallest. It is also the easiest to take, even though it may seem hard at the time.

The only way to overcome this mistake is to have an unbreakable rule (and the discipline to follow it!) that stop/loss orders must be placed each and every time the market is entered. The easiest way to take a loss is to have the stop order waiting before the open or immediately after entering the market. Do your homework when the market is closed, and place your order before the open. Another rule to follow; under no circumstances should an initial protective stop/loss order be changed to increase your risk, only to reduce it.

7. Meeting margin calls

Most often, meeting a margin call will only increase trader's loss. A margin call means trader is wrong in the market and his position should be closed out. Margin calls are met because people do not want to admit being wrong and take a loss; because they hope the market will eventually go in their direction. Margin calls are the result of making one or more of the 12 CARDINAL MISTAKES such as not having a game plan, not using stop/loss orders, overtrading or poor money management.

8. Increasing your commitment with success

One of the most dangerous mistakes traders can make in trading commodities is to increase their exposure, as they become more successful. Just by being successful trades will risk more dollars per trade because they have more money. But, because they have more money (and confidence) when successful, they also likely to take larger percentage risks. Not surprisingly, this ruins more futures traders than a series of small losses.

Traders can overcome this mistake by not allowing their percentage commitment to increase as they realizes profits and by maintaining the stop/loss discipline.

9. Overtrading your account…

…Or risking too large a percentage of equity on any single trade, either with too large a dollar risk per contract or by trading too many contracts for any single trade or by trading too many commodities.

This also happens after a period of success when traders *"know"* that the market is going to do something. They are so certain that this is going to be a really big move that they risk much more than the maximum 10% of their equity. Already emotionally out of balance, all it takes is a couple of limit moves against them and they are bust.

To prevent this mistake from occurring, traders must have a hard and fast rule that they can risk no more than a certain percentage of their equity on any trade regardless of how good the trade looks.

10. Failure to remove profits from your account

It is almost a natural law that the commodities markets over a given period of time will allow trader to make only so much money and then he is going to have to start giving some back. Yet, probably no more than 1% of all commodities traders I know have a rule to take profits out of their account. (But, they never fail to put money into their accounts as they meet margin calls.) Almost always, they leave profits in their accounts and go for the "big trade" — the one that will give them a real "killing" — and usually kills their profits.

This can be overcome by predetermining an equity level at which trader remove profits from his account. When the trader makes profits in the commodities markets, take some money out and put it somewhere else. The commodities markets are not a cornucopia. As all commodity traders will move in cycles. The trader will make some, lose some, make some, lose some. By taking money out of his account when he is profitable, he will not make the mistake of losing larger amounts of money when his down cycle begins.

11. Changing your strategy during market hours

During market hours the trader is subject to emotional reactions of fear and greed much more than he is when the market is closed. Have a trader ever noticed that when he sits down in the quiet of the night before the trading day he can very calmly figure out what he want to do the next day; yet, shortly after the market opens he does exactly the opposite of what he had planned.

With rare exception, the best approach is to not change your trading strategy during market hours unless there is an unexpected news event or market reaction. Overcome this mistake by developing trading strategy before the market opens and having the discipline to not change the game plan during the day.

12. Lack of patience …or trading for the excitement, not the profit.

The average life of a commodity trader is somewhere between five minutes and nine months. Not all commodity traders trade because they want to make money. Many trade because they want the action. Think about it -- must a trader has a trade a day, or can he patiently wait for the high probability trades, even if it means standing aside for a week or two?

For those traders who wish to learn how to make money in the commodities markets, rest assured they can. However do not expect to make money in each and every trade. If a trader concentrates on not breaking the 12 CARDINAL MISTAKES of commodities trading, he has a greater probability of making money over a period of time. Certainly he will have losing trades. Certainly the market will do the unexpected and at times trader will lose more than he expected; but if he steadfastly avoid making these mistakes he must make money.

By studying the past history of a market, a trader can isolate high probability trades and situations that offer exceptionally large profits relative to the dollar risk.

A trader must evaluate his own trading and determine whether he really trades to make money, or for the action and excitement. To overcome this mistake, a trader must develops patience, do his homework, and research markets for high probability trades.

Glossary

Commodity Exchange

An entity which determines and enforces rules and procedures for the trading of commodities and related investments, such as commodity futures. Commodities exchange also refers to the physical center where trading takes place.

Physical Commodity

Generally physical commodities can be broken down into:

- Soft Commodities: agricultural products i.e. wheat, corn, soybean, coffee and sugar
- Hard Commodities: natural resources that must be mined or extracted i.e. gold, silver, crude oil etc

Financial Commodity

A commodity that is not based on a physical or tangible asset. It includes Currencies, Equity Securities, Interest Rates, Indices, etc.

Futures Contract

A futures contract is a standardized legally binding contract to buy/sell a commodity in a specific quantity/quality at some time in the future at a predetermined price. Futures contracts are traded in futures exchanges worldwide and cover a wide range of commodities such as agriculture produce, livestock, energy, metals and financial products.

Broker

A commodity broker is a firm or an individual who executes orders to buy or sell commodity contracts on behalf of clients and charges them a commission.

Hedging

Producers and manufacturers can make use of the futures market to hedge the price risk of commodities that they need to purchase or sell in order to protect their profit margins. Businesses employ a long hedge to lock in the price of a raw material that they wish to purchase sometime in the future. To lock in a selling price for a product to be sold in the future, a short hedge is used.

Speculation

Speculators assume the price risk that hedgers try to avoid in return for a possibility of profits. They have no commercial interest in the underlying commodities and are motivated purely by the potential for profits. Speculators play an important role in the futures market. Without speculators bridging the gap between buyers and sellers with a commercial interest, the market will be less fluid, less efficient and more volatile.

Futures speculators take up a long futures position when they believe that the price of the underlying will rise. They take up a short futures position when they believe that the price of the underlying will fall.

Margins

Margins are financial guarantees required of both buyers and sellers of futures contracts to ensure that they fulfill their futures contract obligations. Participants in a futures contract are required to post performance bond margins in order to open and maintain a futures position. Futures margin requirements are set by the exchanges and are typically 2 to 10 percent of the full value of the futures contract.

Initial Margin

Before a futures position can be opened, there must be enough available balance in the futures trader's margin account to meet the initial margin requirement. Upon opening the futures position, an amount equal to the initial margin requirement will be deducted from the trader's margin account and transferred to the exchange's clearing house. This money is held by the exchange clearinghouse as long as the futures position remains open.

Long Futures Position

The long futures position is an unlimited profit, unlimited risk position that can be entered by the futures speculator to profit from a rise in the price of the underlying. The long futures position is also used when a manufacturer wishes to lock in the price of a raw material that he will require sometime in the future. See long hedge. To construct a long futures position, the trader must have enough balance in his account to meet the initial margin requirement for each futures contract he wishes to purchase.

Short Futures Position

The short futures position is an unlimited profit, unlimited risk position that can be entered by the futures speculator to profit from a fall in the price of the underlying. The short futures position is also used by a producer to lock in a price of a commodity that he is going to sell in the future. See short hedge. To create a short futures position, the trader must have enough balance in his account to meet the initial margin requirement for each futures contract he wishes to sell.