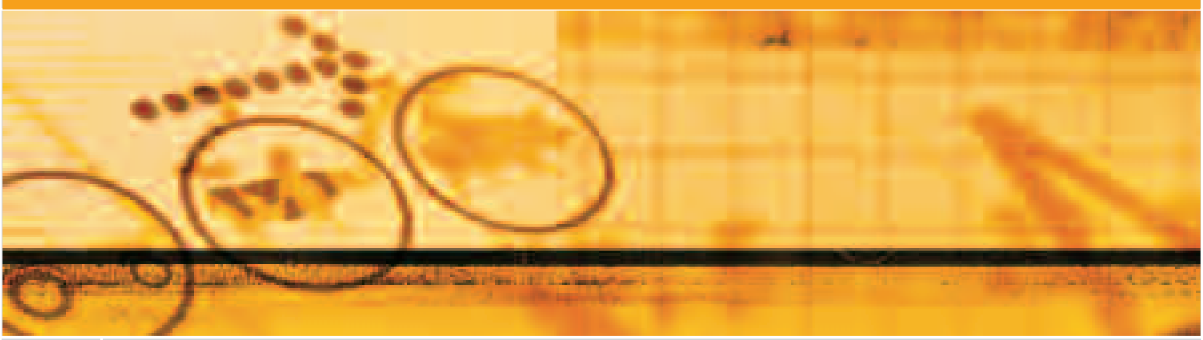
Chicago Mercantile Exchange

CME COMMODITY PRODUCTS

An Overview of CME Commodity Futures for Hedgers



Global Leadership in the Financial Marketplace

CME is the largest and most diverse financial exchange in the world for trading futures and options – handling more than 1.3 billion contracts worth more than $827 trillion in 2006. Founded in 1898, we serve the risk-management needs of customers around the globe by offering the widest range of benchmark financial products available on any exchange, traded via our CME Globex® electronic trading platform and on our trading floors.

Our innovative products cover major market segments – including interest rates, equities, foreign exchange, commodities and alternative investment products such as real estate, weather and economic derivatives – and improve the way these markets work for customers everywhere. In addition, CME Clearing matches and settles all trades and guarantees the creditworthiness of every transaction that takes place in our markets.

CME Commodity Products

CME agricultural commodity products help farmers and agribusinesses manage the constant price risks they face by making it possible for them to lock in profits, minimize losses, enhance business planning and more effectively serve their markets.

CME commodity products include futures contracts based on cattle, hogs, pork bellies, dairy products, lumber and fertilizer. These products, which are the origin of our exchange, remain in a growth mode and continue to achieve new volume records.

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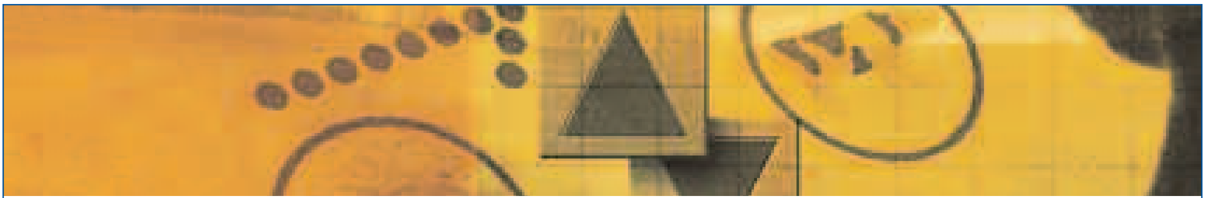
What are Futures and Options?

Futures contracts are standardized, legally binding agreements to buy or sell a specific product or financial instrument in the future. The buyer and seller of a futures contract agree on a price today for a product to be delivered or settled in cash at a future date. Each contract specifies the quantity, quality and the time and location of delivery and payment.

The value of a futures contract is derived from an underlying financial measure or market, such as commodity prices, equity index levels, foreign exchange rates or interest rates – hence the term derivatives. As the value of the underlying measure or market changes, the value of the futures contract based on that measure or market also changes. Institutions and individuals that face financial risk based on the movement of the underlying measure or market can buy or sell futures that will change in value to offset that financial risk. Such transactions are known as hedging. Institutions and individuals also buy and sell futures hoping to profit from price changes. These transactions are considered speculation.

CME also offers investors options on futures. Options can be thought of as insurance policies. The option buyer pays a price for the right – but not the obligation – to buy or sell a futures contract within a stated period of time at a predetermined price. The combination of options and futures – both risk-management tools – can give market participants the leverage of futures and the more limited risk of options. Options provide the opportunity to limit losses while maintaining the possibility of profiting from favorable changes in the futures price.



What are Commodity Futures?

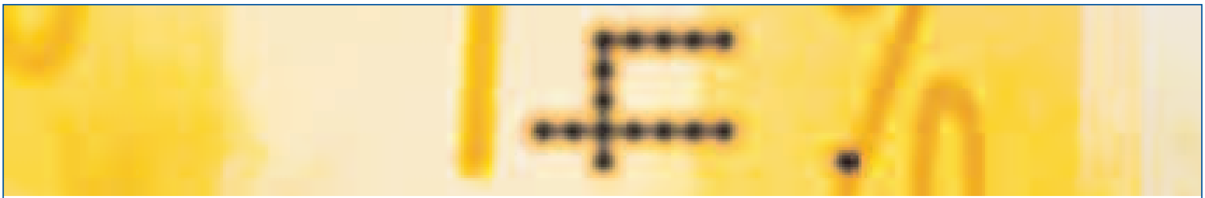
Commodity futures are essentially price agreements. People who trade commodity futures at CME are basically speculating about what they think the prices of specific agricultural products will be at some point in the future – the next minute, next hour, next month or even the next year.

What they trade, more specifically, are contracts – legally binding documents – to buy or sell a specific quantity and quality of a commodity such as live cattle, lean hogs or milk for delivery during a particular month, at a price mutually agreed upon by the buyer and seller, with full payment expected at delivery.

They do not, however, have to hold that contract until it expires. Instead of taking delivery, they can turn around and "offset" the contract with an equal and opposite transaction – buying if they initially sold, selling if they initially bought – and hope that the selling price is more than the price they paid, so that the transaction is profitable. Of course, it is always possible the transaction will not be profitable.

If it sounds strange that people can initially sell a contract for a commodity they do not yet possess, think of it this way: Farmers often agree to sell a crop they haven't yet harvested or possibly even planted. They sell, expecting to have the commodity on hand by the time they will have to deliver it. Futures, which have their origin in agricultural products, work on this principle. If people sell a futures contract intending to deliver the commodity, they know where they will be getting whatever they are selling. But as we've just said, most people don't expect to deliver the commodity they're selling. They're simply waiting for the going price to change in their favor, at which point they will offset their futures agreement at a profit.

Keep in mind, also, that commodity prices change almost constantly, as the markets react to breaking news, weather crises, economic announcements, political events and other situations that can affect the supply and demand for commodities. Whenever people offset a contract, then, it's practically inevitable that the going price of the commodity will be different from the going price at the time they initiated the futures position and that they will either make or lose money on the transaction.



Back to the Basics

A key aspect of trading CME commodity futures and options on futures is that it gets people back to the basics. They're in touch with the real world when they trade agricultural markets – the world affected by floods, sweltering heat, by what people decide to eat and what type of house in which they want to live.

Commodity traders think about whether demand for beef, pork, dairy products or lumber is changing. They ask themselves what they would do if they were in a farm, food or lumber business. Every day, traders at these firms, known as hedgers, use CME markets to manage price risk and enhance profitability.

The "fundamentals" play a big part in commodity price movement. Common sense in analyzing the supply and demand factors that affect prices goes a long way toward making a trading decision. A commodity broker – a broker with a special futures trading license – can also help clients develop a clear understanding of the current market situation.

Commodity futures also are well-suited to individuals and small companies. Other futures markets, such as the treasury bond, stock index or energy markets, can be overwhelmed by the influence of professional traders, governments and institutions, which can sometimes have dramatic short-term influence on price. Many participants in the agricultural futures market are individuals, in addition to institutions and corporations.

How Does Futures Trading Work?

Buy Low/Sell High, or Vice Versa

The secret to futures trading is to "Buy low, sell high." People who buy something at one price and sell at a higher price make money. If they buy something at one price and sell it at a lower price, they lose money. In futures and options on futures people can buy and sell in whatever order they want; it's just as easy to "sell high, buy back low," as it is to buy low, sell high. If people think prices are going up, they establish "long" (buy) positions, and if they think prices are going down, they initiate "short" (sell) positions.

The Power of Leverage

CME commodity futures markets, like futures markets everywhere, are "leveraged" markets. That means that people need only to commit a little money to control a lot of product – in other words, when they initiate futures positions, they usually put up only an initial "performance bond" of about five percent to 10 percent of the value of the position, and are then required to maintain a specific amount in their trading accounts while their positions are still open.

Futures prices move quickly – here's an example of just how quickly a substantial move can occur: Suppose that in October, December Live Cattle futures rose 5 cents per pound over 10 trading days as the number and weight of cattle on feed decreased. A trader who bought a December cattle contract at 85 cents on a margin of $1,080 would have earned $2,000 as prices rose to 90 cents, for a return of 185 percent on the initial investment (5 cents x 40,000 pounds) in little more than a month, not counting the commissions and fees.

Another trader, anticipating that supermarkets typically feature more beef prior to the July 4th holiday, could buy a June Live Cattle contract at 80 cents and sell that contract back in mid-June for 91 cents, for a gain of close to $4,400 on an initial margin of $1,080 – a 400 percent return, again not counting commissions and fees. Remember, however, that the trader could have sold a contract first and then bought it back at a loss. *It's just as easy to sustain a loss as it is to realize a gain in these markets.*

Agricultural futures contracts are seldom held very long. Usually, they are offset by an equal, but opposite, futures transaction that takes the trader out of the market.

Because most commodity markets can move significantly from one trading day to the next, futures traders often get in and out of the market in a single trading day. However, if they hold their positions until the contract delivery month, they can choose to make delivery (if they have sold a contract) or take delivery (if they have bought one) of the underlying commodity. Alternatively, many CME contracts are cash-settled.

The initial performance bond requirement is relatively small compared to the value of the contract, and the resulting leverage can lead to quick and substantial profits (or losses). In fact, it's possible to lose more than the amount of money initially deposited as a performance bond. A good rule of thumb for commodity traders is to use only funds they can afford to lose without affecting their lifestyles. And, only a portion of these should be devoted to any one trade.

Remember, not every trade will be a "winner." Some very successful traders may only "win" on 30 percent to 40 percent of their trades. The key is to cut losses short, and to let profits run.

Trading Decisions: Fundamental and Technical Analysis

Trading decisions typically are based on analysis that suggests that a commodity's fundamental or technical outlook is going to change. Fundamental analysis includes the product's supply and demand forces; technical analysis encompasses a wide range of charting techniques involving a commodity's price movements, seasonal data or demand cycles. Most traders define their approach as primarily fundamental or technical, but often use elements of the other approach to reach a well-grounded trading decision. Commodity brokers are usually well-versed in either fundamental and/or technical analysis, and can help guide clients in developing trading strategies and decisions.

Information Sources for Fundamental Analysis

Live Cattle and Feeder Cattle

The supply of beef cattle is a main fundamental focus for traders of cattle futures. Feeder cattle are young animals sent to feedlots for finishing into "fed" cattle, the basis of CME Live Cattle contracts. Beef cattle supplies are largely influenced by weather conditions, profitability and the price of feed. A key source of free livestock market information is the Daily Livestock Report – www.dailylivestockreport.com. Industry experts and traders also read the two major U.S. Department of Agriculture (USDA) reports: Cattle on Feed, released monthly, and Cattle Inventory, released semi-annually.

Hogs and Pork Bellies

As in the cattle markets, weather conditions and the price of feed play major roles in determining producer profitability and, thus, the supply of hogs. However, hogs operate on a much shorter maturation cycle. A hog is marketed about six months after birth, compared to a beef animal that is marketed about 18 months after birth. Traders pay close attention to the USDA's monthly Hogs and Pigs report.

Once a hog has been slaughtered, the excess pork bellies that are made into bacon are often frozen during fall, winter and spring in order to meet summer's seasonal demand increase. These frozen stocks are reported in the USDA's monthly Cold Storage report.

Random Length Lumber

Lumber prices are very sensitive to demand, which is influenced by general economic conditions affecting the building industry, such as employment levels, interest rates and inflation. The major government report that wood products traders watch is Housing Starts, released monthly.

Milk, Class IV Milk and Butter

Supplies of milk (Class III, used for cheese) and Class IV Milk (used for butter/nonfat dry milk) are greatly influenced by weather and feed costs. To keep up with the supply situation, traders refer to the free Daily Dairy Report – at www.dailydairyreport.com – and to the USDA's monthly Dairy Products and Milk Production reports.

Demand for milk and milk products such as butter, cheese and fluid milk is highly seasonal, often fluctuating around major holidays and usually peaking between school startup and the Super Bowl. To track cheese and butter stocks, traders follow the USDA's monthly Cold Storage report.

Fertilizers: DAP, UAN and Urea

The U.S. fertilizer industry is heavily dependent on natural gas, the prices of which have been volatile since the 1990s and continue to vary greatly. A main source of information on the fertilizer industry is the Fertilizer Institute Web site – www.tfi.org.

Technical Analysis

The theory behind technical analysis is that all known fundamental information is reflected in the current futures price. The most common starting point for technical analysis is the bar chart that plots a trading period's opening, high, low and closing prices. Traders watch for new highs and lows, broken trend lines and patterns that are thought to predict price targets.

Seasonal patterns are particularly strong in the cattle, hog, lumber and dairy markets as annual supply and demand forces repeat themselves. Cycle analysis looks at longer-term price trends.

The Trading Process

How Orders are Executed on the CME Trading Floor

People call their brokers with instructions to buy or sell CME commodity futures or options for floor-traded contracts. These orders are transmitted directly to the CME floor via telephone or data transmission lines. Upon receipt, the order is time-stamped and delivered to the trading area, or pit, by an order clerk or runner, or it may be flashed directly into the pit via hand signals. The trading pits are each divided into a number of sections designated for trading in particular contract months. No trading may occur outside a contract's assigned pit, nor is trading permitted at any time other than during those hours which have been designated by the Exchange. Floor brokers, who are licensed by the federal government to execute trades for the public, are responsible for executing all open outcry orders.

Trading CME Commodity Products Electronically

It is now possible to trade a number of CME commodity products electronically via the CME Globex electronic trading platform. Electronically traded contracts include CME Fertilizer futures and CME Cash-Settled Butter futures (both of which are available online only). In addition, CME offers three E-Livestock products: electronically traded CME Feeder Cattle, CME Live Cattle and CME Lean Hog futures. These contracts trade online simultaneously with floor trading of the products, with liquidity provided by designated market makers. CME offers free live quotes on these products in the Market Data section of our Web site, at www.cme.com/datasuite.

Many commodity traders enjoy the speed and convenience of electronic trading, as well as the ability to view the top five bids and offers on the product they wish to trade. Electronic market participants enter their own trades into the CME Globex matching engine, provided they already have a futures account and software that gives them access to the CME Globex platform. That software, called a front-end system, is available through brokers, CME and independent software vendors (ISVs) who provide off-the-shelf or customized front-end systems.

Those who would like to trade the electronic agricultural markets but don't have access to a computer or the right software simply have their brokers enter electronic trades on their behalf.

Price Limits

CME agricultural markets have daily price limits, which means that prices can move only a certain amount in any trading day. These limits are determined by the CME Clearing House [with Commodity Futures Trading Commission (CFTC) approval] on the basis of variations experienced in the underlying cash markets, and are adjusted from time to time as price volatility changes. In some commodities, the contract month trades without limits for a short period before its expiration. Commodity brokers can provide the most current information on these limits.

Tracking Prices

"What's the current price?" is the first and most important question in futures trading. Price information is available from:

» Internet: www.cme.com

» Brokers

» Quote vendors

» Major daily and weekly newspapers

» Financial programs on television and radio

» Online computer information services

Order Types

Traders can give their brokers a variety of instructions to ensure they get exactly the type of order execution they want. Many also rely on their brokers for expert advice as to which instructions to use in a particular market situation.

Market (MKT) An order to be executed immediately at the current market price.

Limit An order that can be executed only at a specified price or better.

Day An order that automatically expires if it is not executed on the day it is entered.

Open An order that remains in force until canceled or until the contract expires. This is also called a "good-'til-canceled" order.

Spread An order to simultaneously buy and sell at least two different contracts at a quoted differential.

Stop An order that becomes a market order only when the market trades at a specified price; also called a "stop-loss" order.

Product Codes

Abbreviations identify CME commodity products and contract months on quote tickers, with product code followed by month code. For example, CME December Live Cattle would be LCZ (LC for Live Cattle, Z for December). Codes for CME commodity products are as follows:

Product	Floor-Traded	CME Globex
CME Live Cattle	LC	LE
CME Feeder Cattle	FC	GF
CME Lean Hogs	LH	HE
CME Frozen Pork Bellies	PB	GPB
CME Random Length Lumber	LB	
CME Milk (Class III)	DA	
CME Class IV Milk	DK	
CME Butter	DB	
CME Cash-Settled Butter		CB
CME DAP		DP
CME Urea		UF
CME UAN		UL

How to Read Commodity Prices

Finding futures and options prices is fairly easy, but it is important to know how to decipher them. Although the amount of information published by various sources often differs, most information will look something like Tables 1 and 2.

TABLE 1 Futures

Cattle – Live (CME) 40,000 lbs; cents per lb.

	Open	High	Low	Settle	Change	Lifetime High	Lifetime Low
OCT05	85.40	86.30	85.10	85.50	+ 20	87.88	79.30
DEC05	87.90	88.60	87.50	87.95	- 2	88.75	80.20
FEB06	89.05	89.77	88.80	89.10	+ 10	89.78	82.10
APR06	87.10	87.77	87.10	87.20	- 22	87.98	83.30
JUN06	83.02	83.50	82.80	82.85	- 17	84.90	78.80
AUG06	82.80	82.85	82.60	82.60	- 10	82.85	78.60
OCT06	83.50	83.50	83.50	83.50	+ 10	83.50	83.00
Est. vol. 42,908							
Open int. 151,088							

Daily newspaper listings reflect the previous day's trading information. Open interest listed is from the day before that. Here are some terms you'll need to know to read the tables:

Open *The average price at which the first bids and offers were made or the first transactions were completed.*

High *Top bid or top price at which a contract was traded during the trading period.*

Low *Lowest offer or the lowest price at which a contract was traded during the trading period.*

Settlement price *The official daily closing price, typically set at the midpoint of the closing range.*

Net change *The amount of increase or decrease from the previous trading period's settlement price.*

Life-of-contract highs and lows *The highest price or bid and the lowest price or offer reached in the lifetime of a futures contract or a specific delivery month.*

Volume *The number of contracts traded (one side of each trade only) for each delivery month during the trading period.*

Open interest *The accumulated total of all currently outstanding contracts (one side only). Refers to unliquidated purchases and sales.*

Strike price *The price at which the buyer of a call (put) option may choose to exercise the right to purchase (sell) the underlying futures contract. Also known as exercise price.*

Put *The right, but not the obligation, to sell a futures contract at the option's strike price on or before the expiration date.*

Call *The right, but not the obligation, to buy a futures contract at the option's strike price on or before the expiration date.*

Settle *Same as settlement price.*

TABLE 2 Options
Cattle – Live (CME) 40,000 lbs; cents per lb.

Strike Price Oct. 05	Calls - Settle Oct. 05	Strike Price Oct. 05	Puts - Settle Oct. 05
79	6.60	74	.02
80	5.65	75	.02
81	4.75	76	.05
82	3.80	77	.07
83	2.95	78	.10
84	2.17	79	.12
85	1.45	80	.15
86	.95	81	.22

Trading Examples

The following example illustrates two "perfect trades" – which means things rarely work out quite this well when trading with real money. They are based on an October hog trade placed after a bullish USDA Hogs and Pigs report in 2005 and reversed at the height of the Midwest's growing season in July 2005. The first trade was to buy October hogs at 55.50 cents on June 27 following a bullish Hogs and Pigs report. The initial margin for the trade was $1,080. Willing to risk $600, the trader placed the stop-loss order at 54 cents. Prices rallied throughout early July. The trade was exited on July 6 when prices reached 59.50 cents, for a 400-point, or $1,600, profit per contract. In just less than a month, the initial performance bond investment of $1,080 had returned 148 percent!

The second trade, a short position established on July 8 at 59.50 cents (with a stop-loss order at 61 cents), was liquidated on July 27 at 56.50 cents, for a profit of $1,200 and a return on initial margin of $1,080.

As previously mentioned, had the markets moved differently or the trader entered and exited the market at different times and prices, each of these trades could have resulted in a loss.

Getting Started in CME Commodity Futures

Today's greater need for risk management and hedging tools has required investors to become increasingly sophisticated about futures and options on futures products. In light of growing global demand and expanding electronic accessibility, CME agricultural commodities are generating increased opportunities for hedgers and speculators in these markets. Before trading futures, one needs to take the following steps:

Select a Broker

Futures and options contracts are bought and sold through brokerage firms, just like stocks. Many people talk to several commodity brokers before making a decision to make sure they feel comfortable with their choices. Brokers represent their clients and will enter orders as their clients instruct and report the execution price back promptly. Clients often ask their brokers for advice and help on various aspects of the market and to simply "be there" when they have questions.

All brokers in the U.S. must pass qualifying examinations and receive a government license before they are permitted to handle customer orders. The registration status of a broker, or "Associated Person (AP)," is available from the National Futures Association at 312.781.1410.

Sign Account Papers

After finding a broker who meets their needs, clients then open a trading account, and this involves several steps. Each client must meet the financial requirements set by their particular broker and must sign a risk disclosure statement indicating that the client understands the risks involved in futures and options trading. Other documents to sign typically include a margin agreement (a statement that binds you to pay for any losses incurred during the course of trading) and a commodity account agreement outlining how the account is to be handled by the broker.

Deposit a Performance Bond

After opening an account to trade CME commodity futures or options, clients must deposit a performance bond – either a cash deposit or another form of collateral – with their broker. CME establishes minimum initial and maintenance performance bond levels for all products traded at the Exchange; brokers' requirements may be higher.

Marking to the Market

At the end of each trading day and all following days that a futures position remains open, the contract value is "marked-to-the-market" and each account is credited or debited based on the settlement price on that day's trading session.

If an account falls below the maintenance level (a set minimum margin per outstanding futures trade), the broker will contact the client for additional funds to replenish it to the initial level. Of course, if a position generates a gain, the client can withdraw any excess funds from the account.

Commissions

Commission costs vary according to the services provided by a brokerage firm and are negotiable. For futures and options contracts, the commission is normally a "round turn" fee charged to cover the trades you make to open and close each position. This is payable when you exit the position.

Financial Safeguards of CME

CME uses sophisticated risk management and financial surveillance techniques to protect Exchange members and customers from default on futures and options contracts. CME Clearing guarantees contract performance. CME Clearing members represent more than 80 large, nationally known, financially sound brokerage firms. All floor traders must be affiliated with one of these firms. After each trade is verified, CME Clearing acts as the third party to every trade (the seller to every buyer and the buyer to every seller), thus ensuring the integrity of all trades. CME is financially backed by its clearing members as well as a special Trust Fund. This combination provides unparalleled safeguards for the protection and benefit of all CME market users. In the entire history of CME, there has never been a default or failure resulting in a loss of customer funds.

The Trading Plan

A well-organized trading plan – and the discipline to follow it – are essential elements of a successful trading program. That's because CME commodity futures and options on futures are not long-term investments that a trader can just buy and forget. They typically require monitoring on at least a daily (sometimes hourly or less) basis because of the large impact a small price move can have on an account. A commodity broker can be a key in helping traders develop their plans and stay alert to important market changes.

A tool that can help with developing the discipline to follow the plan is a simple sheet to record trades and the reason they were placed. This could be either in a hard copy or an electronic format. The tracker sheet also serves as a way to double-check against brokerage statements.

Take Advantage of the Possibilities

With customers around the world; a diverse product line; deep, liquid markets; and strategic alliances with other exchanges, CME is truly a global marketplace. Why not make it yours?

For additional information about CME commodity products, please visit our Web site at www.cme.com/commodities. You will be able to access a number of other brochures and marketing and education materials that can answer your questions or help you to begin trading these products. Additionally, if you would like to talk to a CME representative, please call our Customer Service Line, 800.331.3332. Outside the U.S., please call 312.930.2316.

CME Commodity Products

CME offers a range of futures and options on livestock – cattle and hogs – as well as on several dairy-related products. Additional products are based on lumber, fertilizer and the Standard & Poor's® Goldman Sachs Commodity Index™.

CME Livestock

» CME Feeder Cattle Futures and Options (young cattle)

» CME Live Cattle Futures and Options (market-ready animals)

» CME Lean Hog Futures and Options

» CME Frozen Pork Belly Futures and Options (the first futures on frozen meat products, launched in 1961)

CME Lumber

» CME Random Length Lumber Futures and Options

CME Dairy

» CME Class III Milk Futures and Options

» CME Class IV Milk Futures and Options

» CME Butter Futures and Options

» CME Cash-Settled Butter Futures

» CME Nonfat Dry Milk Futures and Options

» CME Dry Whey Futures

CME Fertilizer Futures

» CME DAP Futures

» CME UAN Futures

» CME Urea Futures

Standard & Poor's Goldman Sachs Commodity Index™

» S&P GSCI™ Futures and Options

» S&P GSCI™ Excess Return Futures

Futures trading is not suitable for all investors, and involves the risk of loss. Futures are a leveraged investment, and because only a percentage of a contract's value is required to trade, it is possible to lose more than the amount of money initially deposited for a futures position. Therefore, traders should only use funds that they can afford to lose without affecting their lifestyles. And only a portion of those funds should be devoted to any one trade because a trader cannot expect to profit on every trade. All references to options in this brochure refer to options on futures.

Chicago Mercantile Exchange

IDEAS THAT CHANGE THE WORLD™

CME – Chicago
20 South Wacker Drive
Chicago, Illinois 60606-7499
Tel: 312 930 1000
Fax: 312 466 4410
E-mail: info@cme.com

CME – London
Watling House
33 Cannon Street
London EC4M 5SB, United Kingdom
Tel: +44 20 7796 7100
Fax: +44 20 7796 7110
E-mail: cmeeurope@cme.com

CME – Hong Kong
One Exchange Square
8 Connaught Place, Level 39
Central, Hong Kong
Tel: +852 3101 7696
Fax: +852 3101 7698
E-mail: cmeasiateam@cme.com

CME – Sydney
Level 17, BNP Paribas Centre
60 Castlereagh Street
Sydney NSW 2000, Australia
Tel: +61 2 9231 7475
Fax: +61 2 9231 7476
E-mail: cmeasiateam@cme.com

CME – Tokyo
Level 16 Shiroyama JT Trust Tower
4-3-1 Toranomon Minato-ku
Tokyo 105-6016, Japan
Tel: +81 3 5403 4828
Fax: +81 3 5403 4646
E-mail: cmeasiateam@cme.com

Internet
www.cme.com

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