# Managing Risk with Commodity/ Financial Futures

At RBC Dominion Securities, we have been helping individual and corporate clients achieve their financial goals since 1901. Today, we are Canada's leading provider of wealth management services, trusted by more than 400,000 clients globally. In the area of commodity/financial futures, we provide the most comprehensive services available from any investment firm in Canada, including professional advice and trade execution.

## What Are Commodities and Commodity Futures?

A commodity is a product used for commerce that is traded on an organized exchange. Types of commodities include agricultural products (such as corn or wheat), metals, petroleum, currencies and financial instruments.

The Chicago and New York exchanges are the centres of commodity futures trading in North America. Here in Canada, commodities such as feed wheat, canola and western barley trade on the ICE Canada Exchange, and banker's acceptance futures and index derivatives on the Montreal Futures Exchange.

Through a futures contract, you can agree to sell or buy a commodity at a certain price at a future date. Futures can be invaluable risk management tools for commodity producers and consumers, from smaller family-owned businesses to large-scale industrial enterprises. They may also be important for individuals with large investment portfolios that are exposed to market and currency risk.

## Helping You Meet a Wide Range of Needs

- If you are a producer of a commodity, managing the risk of price fluctuations may be a major concern. When used appropriately, commodity futures and options can help reduce this risk.
- If you own a small business that uses a certain commodity to produce value-added goods, hedging can help you gain greater cost certainty for that commodity through the futures market.
- If you are a qualified, sophisticated investor, commodity futures may be an appropriate way to manage risk by adding an additional dimension of diversification beyond the three traditional asset classes – stocks, bonds and cash.

For example, commodity futures historically have a direct negative correlation to stocks – a bull market in stocks is usually met with a bear market in commodities, and vice versa. Last century's longest

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commodities bull market began in 1933 – the year of the Great Depression.

In addition, by trading equity index futures, you can benefit when an equity market moves up – or down. For example, if you own a large stock portfolio with significant exposure to a certain equity index, you could hedge against a potential decline by using equity index futures.

- If you are a Canadian citizen who owns a large U.S. stock portfolio, you know how the changing U.S./Canada exchange rate can impact your returns in Canadian dollars. Through the use of foreign exchange futures, it is possible to reduce or eliminate this risk.

## Managing Risk and Benefiting from Favourable Price Changes

There are essentially two types of participants in futures markets: hedgers and speculators. Hedgers are looking to gain better control over costs and prices in order to make a reasonable profit in regular business operations. Users or producers of commodities are most likely to be hedgers. Speculators buy or sell commodities or futures contracts in order to profit from favourable price changes.

### Hedging

Hedging is a strategy used to reduce the risk of unfavourable price changes in a certain commodity or currency. Let's use a currency hedging strategy as an example. A Canadian investor with a U.S. investment portfolio is concerned about the impact of a rising Canadian dollar. If the value of the Canadian dollar rises 5% against the U.S. dollar, then the portfolio would be worth 5% less when converted to Canadian dollars. To provide a hedge against this, the investor buys futures or call options contracts on the Canadian dollar.

If the Canadian dollar goes up, the investor sells the futures or call options contracts at a profit, offsetting the losses in the U.S. portfolio due to the rising Canadian dollar. If the Canadian dollar goes down, the investor sells the futures or call options at a loss, offsetting the gains on the U.S. portfolio due to the falling Canadian dollar. In either case, the investor has mitigated the impact of Canadian/U.S. currency fluctuations on the U.S. portfolio when expressed in Canadian dollars. While not benefiting from a falling Canadian dollar, the investor is protected if it goes up.

### Speculating

A speculator in the futures market is not usually a direct consumer or producer of commodities, nor does one

RBC Dominion Securities provides timely, efficient trade execution services so you can get the best possible prices available on the full range of futures and options.

Futures and options strategies range from the very basic to the very sophisticated, depending on your needs.

have to be in futures to be a speculator. Let's say you've done some research and you're of the opinion that the value of the Canadian dollar is going to strengthen against the U.S. dollar. You purchase an option or a futures contract to buy the Canadian dollar at the current price.

If you are correct in your assumption and the Canadian dollar appreciates in value, you would sell the option or futures contract and pocket the gain. Should the price go down, you would lose the premium that you paid to have the option to buy the Canadian dollar at today's price.

Speculators play an essential role in commodities markets. They improve the ease of transactions by injecting liquidity into the system and increasing the numbers of those willing to buy and sell, and by taking on some of the risk that hedgers are trying to avoid.

Speculating in commodity futures is a high-risk investment strategy that is not suitable for all investors. Before implementing any futures or options strategy, you should always consult with a qualified professional.

## Access to Global Futures Markets

RBC Dominion Securities is a full-service brokerage with offices across Canada. We offer access to all commodity futures exchanges globally, including:

- Chicago Mercantile Exchange
- Chicago Board of Trade
- New York Mercantile Exchange
- New York Board of Trade
- Montreal Futures Exchange
- ICE Canada
- Hong Kong
- London

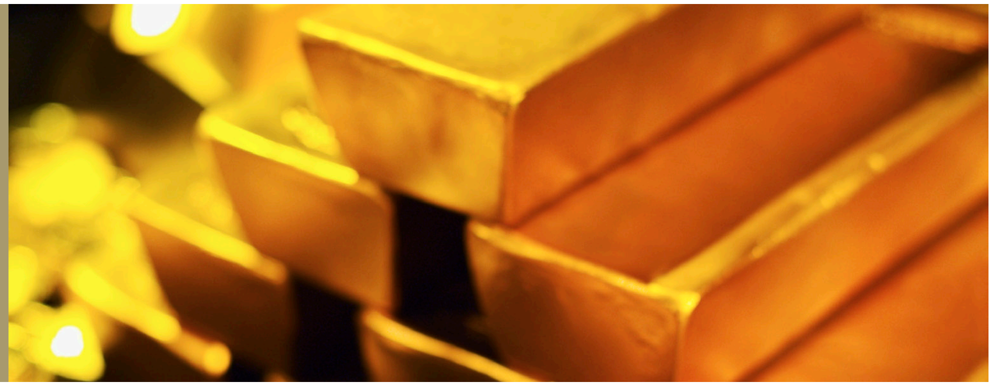
We provide timely, efficient trade execution services so you can get competitive prices on the full range of futures and options:

- Energy (crude oil, natural gas, heating oil and gasoline)
- Precious metals (gold, silver, platinum and palladium)
- Base metals (copper and aluminum)
- Currencies
- Financials (bonds, Eurodollars)
- Stock indexes
- Agriculture (cattle, hogs, soybeans, corn, wheat and oats)
- Soft commodities (coffee, cocoa, orange juice)
- Fibre (cotton, pulp and lumber)

## Professional Assistance with a Personal Touch

Trading in futures requires highly specialized knowledge. In order to provide advice on futures, Investment Advisors must complete advanced

Whether you are looking for secure cash flow, cost certainty, portfolio protection or enhanced return potential, we can create a strategy to meet your needs.



RBC Dominion Securities is Canada's leading commodity future broker, offering expert advice, access to global futures markets and in-depth research.

coursework through the Canadian Securities Institute, including the Futures Licensing Course (FLC). This provides you with the peace of mind of knowing that you are working with a qualified professional who is also backed by the resources and expertise of RBC Dominion Securities, Canada's leader in commodity/financial futures.

## Custom-Designed Solutions

We are focused on helping you make the best decisions about futures based on your individual needs. Whether you're an agricultural entrepreneur looking for a secure cash flow or a small business owner looking for cost certainty, we can create a customized strategy that meets your needs.

Futures and options strategies range from the very basic to the very sophisticated, depending on your needs. This includes various options strategies that can benefit from rising, falling or sideways markets. We also offer foreign exchange/commodity risk management products.

## Research and Analysis

Our Futures Risk Group provides access to leading commodity research advisors who provide insight on various commodity sectors and recommendations on hedge strategies.

*Please contact us for more information about commodity/financial futures, and to determine if this portfolio strategy is appropriate for you.*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