Single Stock Futures
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Single Stock Futures: A Trader’s Guide
Patrick L. Young and Charles Sidey

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Make No Small Plans

Daniel Burnham, famous late 19th century Chicago architect

It all started at Wiltons. A lot of things to do. Somewhere between the quail eggs and the bread pudding our conversation turned to the challenge that was facing my friend.

It was 1997 and Sir Brian Williamson had just agreed to become Chairman of Liffe—the embattled derivatives exchange that was fighting for survival. Its demise would be a significant chink in London’s armor and threaten the city’s preeminence as a financial center. The first step was clear: close the floor and migrate all trading to an electronic platform. Easily said, but never before successfully accomplished on this scale. The second step was equally challenging. Invent a product complex that had the potential to be as significant as the interest rate complex.

As a student of markets the path was obvious. Equity derivatives had a long history. Futures and options on single stocks had been traded in Amsterdam in the 17th century. Their natural evolution demonstrated their importance as a risk-shifting mechanism. For a variety of institutional and legal reasons they were dormant for centuries. Modern equity derivatives began in 1973 at the Chicago Board Options Exchange and had been successfully imitated worldwide. This was followed by the invention of stock index futures at the Kansas City Board of Trade. These were successfully innovated at the Chicago Mercantile Exchange and ultimately imitated worldwide. The missing piece of the puzzle was a futures market on single stocks. I had unsuccessfully tried to fill this gap in 1982 at the Chicago Board of Trade with the design of narrowly-based indices, which in some industries were surrogates for single stocks. This
led to the Shad–Johnson accord between the SEC\textsuperscript{1} and CFTC\textsuperscript{2}, which banned narrowly-based indices. The legal ban on single stock futures and surrogates still left the complex incomplete.

While the elimination of the ban in the United States seemed daunting the prospects in London seemed better, particularly if it was championed by the right individual. It required the vision of a divergent or outsider mentality coupled with competencies of a convergent or insider mentality. Sir Brian had these qualities. Ultimately the stamp tax on futures disappeared and the Bank of England and the Securities and Futures Authority recognized the rationality of the concept. The timing was also right. Debt was a 1980s commodity and equity a 1990s commodity. The U.S. financial sector provided the paradigm. In 1990, there was $2 trillion in the form of Federal debt in the U.S. Ten years later that figure had risen to $3 trillion, while during the same period the size of the U.S. equity market rose from $3 to $14 trillion. Europe was having a similar transformation.

By the time the armagnac and cigars arrived the path seemed clear. One last question remained. How would this resonate in the United States? Liffe would list both U.S. and European stocks. This would inevitably result in political pressures to lift the U.S. ban. We thought that would ultimately broaden the interest in the markets and become a catalyst for a self-fulfilling prophecy. Several years later LIFFE launched Universal Stock Futures. It was successfully imitated in continental Europe. The ban in the United States was lifted and OneChicago and NQLX\textsuperscript{3} launched single stock futures in N.Y. and Chicago in 2002. Liffe had a record volume that very same year. A lot had happened in a short five years.

It was a wonderful dinner with a dear friend.

Richard Sandor
Chicago, January, 2003

\textsuperscript{1} SEC—Securities & Exchange Commission, the US regulator for equity trading.
\textsuperscript{2} CFTC—Commodities Futures Trading Commission, the US commodities and futures regulator.
\textsuperscript{3} NQLX—originally standing for NASDAQ LIFFE markets, NASDAQ withdrew in mid-2003, leaving Euronext LIFFE in sole control. NQLX along with OneChicago are the two principal US single stock futures exchanges.
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Charlie Sidey
Patrick L. Young
London and Monaco, December, 2002
Introduction: Another New Product, Another Revolution

*Universal Stock Futures represent a revolution in global equity trading. They will be easy, cheap and efficient to trade.*

Sir Brian Williamson, Executive Chairman, LIFFE, announcing the launch of the world’s first international stock futures, September 20, 2000

Single Stock Futures (SSFs) represent the most exciting new product launch within the equity derivatives arena since the derivatives bandwagon began exploding in the post-Bretton Woods era of financial deregulation. Their development has been hampered by regulatory issues in the USA, but the launch of NASDAQ LIFFE, and OneChicago in November 2002 brought SSFs to the world’s largest capital market for the first time.

The history of SSFs, as we will outline in Chapter 1, has been a somewhat tortured one, with historical precedents evident in 17th century Amsterdam, although the modern products initially have had a fairly chequered history during the past decade. Nevertheless, nobody can underestimate the sensational potential for SSFs (which in any case have been available both Over The Counter [OTC] and synthetically through options exchanges for some 20 years). Throughout history, the introduction of futures products have enhanced liquidity and trading opportunities in the cash market as well as creating a significant new dimension for traders, hedgers, and risk-managers seeking to improve their returns or sleep easier at night. In an increasingly digital financial market environment, SSFs are a key element of the development of equity derivative products.