

COMMERCE

CHICAGOLAND VOICE OF BUSINESS AND INDUSTRY



Merc executive vice president, Kenneth Mackay, and Miss Idaho of 1967 helped launch potato contract in mid-1968.

Chicago's "Merc" and its Now Generation

Business Booms as Young Ideas
Topple Old Traditions

by Victor Wortman

STANDING quietly on a shelf near Leo Melamed's desk is a curio not common to the offices of many businessmen. Leo Melamed has a gum ball machine. But Leo's machine dispenses Gelusil.

Leo Melamed is the 38-year-old chairman of the board of governors of the Chicago Mercantile Exchange. He

also heads his own firm, Dellsher Investment Co., through which he speculates in commodity futures. What amounts to two full-time occupations keeps Melamed on a fast, 12-to-14-hour-a-day track. And thus, it's vitally important to his stomach that he keep his sense of humor.

As CME's chief executive, Melamed

Trading floor of CME is too small for present and anticipated growth. Quarters have been occupied since 1927.



presides over what is perhaps the hottest exchange in the world. More things have happened in less time than in the entire history of the business. In the past 10 years, the Merc has undergone almost a total reorientation—only two contracts are now traded that were traded a decade ago—and its leadership has established strong plans to allow the institution to move more vigorously in the future. Evidence of the payoff exists in that in 1964, the CME, still laboring under its old "butter and egg" image, handled only three percent of the commodity futures contracts in the U.S. Last year, its share had climbed to 40%. Observers concluded that the Merc held undisputed second place (behind the Chicago Board of Trade), and its momentum shows no signs of slackening. In 1964, Merc seats went for \$3,000; late last year one went for \$90,000.

Everette B. Harris, CME president, tends to credit the influx of young men such as Leo Melamed for the dramatic revival of the Merc's fortunes. "As far back as the end of World War II," he says, "Young men began to come to the Merc with their eyes on success. They didn't have the 'butter and egg' tradition and they weren't caught up in the old fraternal feeling many of the long-standing members had. Throughout the exchange picture you'd find an ingrained conservatism, in securities and commodities exchanges alike. But these younger fellows wanted to explore."

Harris is fond of saying that most progress is made by people who aren't aware that what they want to do can't be done. And in fact, this pet phrase nicely describes the kind of attitude that has come to pervade the Chicago Mercantile Exchange.

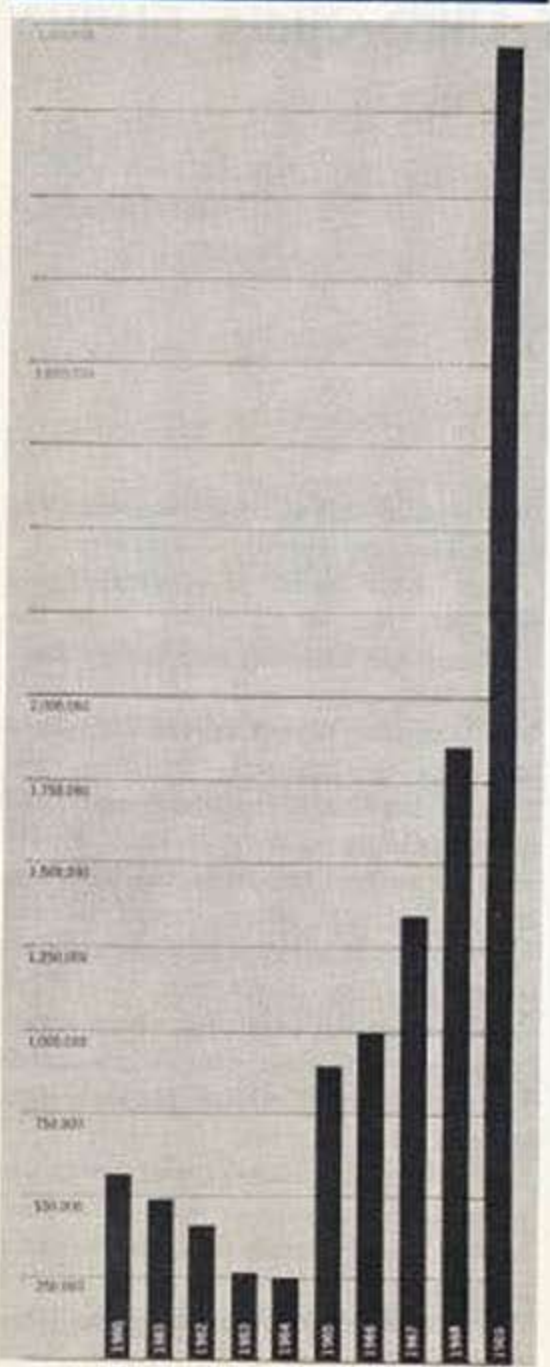
Age of the Pork Belly

The present era at the Merc began with pork bellies, the slabs of uncured side meat that eventually become bacon. The pork belly contract, introduced in September, 1961, was the exchange's first entry into livestock and meat futures. The bellies contract almost immediately became volume leader on the exchange; and in 1965 trading in pork bellies reached a dollar volume that exceeded total trading done at the CME in 1967. In 1969, belly trading soared another 56%. In the first half of 1970 the contract again was the exchange's pacemaker. It is far and away the most active trade in the commodities business.



Board of Governors Chairman Leo Melamed guided Merc through most active year, 1969; also officiated over exchange's commitment to big building and relocation plan.

CME doubled volume in 1969, after steady four-year climb.



With the pork belly contract gaining momentum, Merc leadership took another new step in 1964: introduction of a futures contract in live cattle. This move was in direct opposition to all of the established principles of commodity futures trading. Needless to say, "it couldn't be done." Nevertheless, first half returns for 1970 found the CME live cattle contract running second place to pork bellies. In 1969, more than a million cattle contracts changed hands.

Particularly significant in the introduction of the live cattle contract was that it released the Merc—and the commodity futures business—from a tradition that had, in fact but unbeknownst, been a serious handicap to growth. The tradition was that in order for a commodity to be tradeable on the futures market it had to be storable. Past livestock trading had all been done in a cash market. The conviction that it was the only way livestock could be bought and sold virtually dominated the thinking of traders, commission men and economists. Despite this, the Mercantiles realized that over the years production methods had changed substantially, to the point where growers essentially were involved in a manufacturing process. Supplies could be controlled, for example, and new technologies became available to the large scale producer. Through careful breeding, quality and uniformity could be controlled, with the result that cattle were gradeable prior to slaughter. All of these factors combined to make a contract for deliverable cattle possible.

Untying a Concept

As Leo Melamed says, "Once you become untied from a concept, you can explore ways to use your new knowledge elsewhere." And that is exactly what took place at the CME. Exchange fathers felt that if live cattle could be traded in futures, live hogs could too, despite some differences between the cattle and hog industries. (There is no conflict between the pork belly contract and the live hog contract, since there is little or no direct price correlation between the two.) Following its introduction in early 1966, the live hog contract moved ahead slowly, but Exchange officials felt, satisfactorily. Through 1966, 1967 and 1968, contract volume continued "respectable," with a high of 9,371 contracts traded in 1967. Then, in 1969, realization of the con-

tract's value for hedging and price protection set in among producers and processors. Their attention stimulated the interest of speculators, and once again the triangle necessary for successful futures trading had all three of its sides. In 1969, 63,869 live hog contracts were traded. In 1970's first half, 66,028 trades were made, 554.1% ahead of performance a year earlier.

Something Old, Something New

Similarly, the Merc's approach to egg futures trading altered with the shift of the egg industry from a high curve production cycle to a more stable, year-'round business. Now, rather than refrigerated eggs, the exchange offers a contract for fresh eggs more closely tuned to supply and demand factors. With the movement of egg production to southern states, plus continuously improving technology, the storage egg contract became less and less an economic benefit.

Such attention to economic benefit—the only factor that can sustain a futures contract—led the CME into additional new or revised contracts. A strong new performer (1969) is lumber (random length 2x4s between eight and twenty feet long), which works both for lumber producers and the contractors who use it. Frozen boneless beef, introduced in April, 1970, registered 1,064 trades in its first six weeks indicating that again the Merc had picked a winner. Presently, 10 contracts are traded at the CME. Recently, the turkey contract was sus-

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Part of CME's public relations drive consists of inviting financial editors from leading U.S. newspapers for briefing.





Glamour issue.

One of today's top glamour issues isn't a stock—it's a part of a pig. A frozen pork belly, to be precise. In fact all six commodities traded on the Chicago Mercantile Exchange are rather glamorous. In trading these commodities, the rewards can come quickly and be quite substantial. Naturally, the element of risk is also substantial. For a no-nonsense booklet about the opportunities in commodity trading, send the coupon below.

CHICAGO MERCANTILE EXCHANGE		
111 North LaSalle Street, Chicago, Illinois 60601		
Governor:		
Please send me your free booklet, "Trading in Tomorrow."		
NAME _____		
ADDRESS _____		
CITY _____ STATE _____ ZIP _____		

Whimsical ads set stage for new look at Chicago Mercantile Exchange.

CME financed Poultry and Egg Building in Chicago's Lincoln Farm-in-the-Zoo. Agriculture Secretary Clifford M. Hardin (left) came for dedication. Strolling with him are Dr. Lester Fisher, zoo director and Everette B. Harris (right) CME president.



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pendent from active trading because of a long-standing lack of interest by hedgers and speculators.

The suspension of the turkey contract indicates that no contract is sacred at the Exchange. If they don't grow, they go. Everette Harris points out that, with a willingness to fail in order to succeed, the Merc has adopted and later dropped contracts such as onions, scrap iron, frozen shrimp, frozen broilers (which meanwhile make it big at the Board of Trade), hides and apples. And, experimentation continues. Early this year, though, the Merc put its experimentation on a controlled basis. The exchange hired as a vice president and permanent administrative staff member Dr. Mark Powers, a Ph.D. in agricultural economics and whose doctoral thesis dealt with pork bellies. Dr. Powers is head of research at CME, and represents the first move by any commodities exchange to create a staff position for a professional economist to effectually program future economic directions.

Dr. Powers arrived in January, 1970, following research and teaching assignments at the University of Wisconsin and South Dakota State University. He estimates that in the first nine months of his association with the Merc, approximately 30 possible new commodities have been reviewed, and recommendations for contract development (or otherwise) made to the board of governors. There will be new contracts added to the CME roster in the near future, he says. Besides such commodity review responsibilities, Dr. Powers conducts research in other areas, and functions as coordinator of the Merc's educational program.

Presently in work are two surveys, results from which will be available soon. One seeks to find out the "who?" of commodities trading. This, a survey of the Merc's member firms, has as its objective to identify the types of people who now trade in commodities futures, the better to direct future advertising. The other is an attitude survey, with its objective to learn from a broad-thrust questionnaire just what people think of commodity exchanges and commodity futures trading. Again, this survey will help establish long-term promotional directions and operating policies for the Exchange.

Where these latter exercises are lumped together under the heading of "internal" research by Dr. Powers, an equally strenuous program of "external" research is being carried out. One probe in the external program is directed toward colleges and universities. The Merc provides a basic form of assistance by providing data, methodology and answers to various theoretical questions about commodity trading, upon request.

Long-Range Payoff

In another effort, the Merc provides scholarship help. At one time, this assistance was confined to midwestern schools. But recently it has been opened to nationwide participation, under a new "Fellowship in Futures" program. Under this rather general banner, graduate students who need informational help (theses, papers, etc.) are given it, and those in need of financial assistance may apply to the CME for consideration in its grant program. Professors involved in research related to the commodities markets are also eligible for both informational and financial help. Professors in teaching who wish to know more about commodity futures trading, and who wish to spend some time learning it at the CME can become "visiting staff" under the Visiting Professors program. Here, they learn the ropes by on-the-scene observation and participation. The exchange furnishes both encouragement and money.

And perhaps one of the most unusual projects included in the Merc's college liaison program is a limited-installation distribution of its computerized price quotes, which are fed automatically into some nearby college classrooms. Dr. Powers says he hopes to see the program expanded. "The exchange has taken the approach of long-range payoff," he says. "The existence of the exchange depends on its use by hedgers; if they leave, speculators will too. Now, the guy who's going to be in a management position in major hedging companies in 10 years is in college right now. If he understands commodity futures economics, it will be good for the exchange, because he will be able to use it to better advantage."

Under Dr. Powers' direction, member firms and their solicitors are also getting new attention. Many firms

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don't have formal education programs, he says, so the Merc helps to fill the void that sometimes exists between the solicitor's enthusiasm and his expertise. Seminars to teach management and employees about the market are planned. For, says Dr. Powers, the image of the exchange depends on broker performance. The education program now being developed is intended to help build and sustain a positive image in the minds of present and potential traders. Dr. Powers is, himself, involved in the development of a single qualifying examination for solicitors. He is head of a three-man committee, with other participants coming from the Board of Trade and the New York Exchanges.

Protecting the Public

Such efforts naturally redound to the benefit of member firm customers. And, early this year the CME instituted another, more concrete customer benefit: a \$1.5 million trust to provide financial security to members of the public who deal through exchange members. The move was a pioneer one in the commodities field, and similar to actions taken by the New York, American and Midwest Stock Exchanges recently. The fund intends to serve as partial security in the event that any of the exchange clearing house members (brokerage firms) become insolvent. "This trust is an important addition to, and fulfillment of, the self-imposed responsibility of this exchange," Chairman Melamed said, in announcing establishment of the fund. None of these strategies could have taken place so quickly and so smoothly just a few years ago, Melamed and Harris concur.

Says Melamed, "We have a young-thinking board of governors that is interested in pushing new ideas. So, one of the things that has developed is a new outlook toward our committee structure. A few years ago our committee posts weren't much more than honorary positions. Now they're real working groups, and they're probably the most viable, effective tools the board has. The committees have an important role in governing the exchange. The board doesn't turn down committee recommendations, usually, unless there are strong arguments

against them. As a result, we've got excellent morale among our members, and a lot of people involved."

This attitude led, a couple of years back, to a beefing-up of the Merc's enforcement policies. The board formed an "internal F.B.I.," the Audits and Investigations Department. In effect, they told members, "This is what it's been like. Here's how it's going to be. Members in violation of the rules will be accountable." The A&I department was accepted enthusiastically by members, who felt, as did the board, that one of the quickest ways to dispel the somewhat flamboyant,

snake-oil aura of "butter and egg men" was to put a strong, dramatic foot forward.

Growth Without Chaos

"We do have a democratic institution here," Melamed says. "Ideas and criticism are welcomed, solicited and heard. The administration listens. But we don't have chaos."

With its seemingly pell-mell growth pattern, it is a wonder that there isn't chaos at the Merc. In only one year, the exchange actually doubled its size. But even this had been anticipated.

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Building.

We think the word above is descriptive of our most important function in the American economy.

In a literal sense, we are about to erect the most modern headquarters and trading floor complex of any exchange in the world. It will be located in the all-new Gateway Center in downtown Chicago. An artist's rendering appears above.

In a larger sense, we have been building for years, creating liquid markets for commodities

so that growers, farmers, processors and the public may buy, sell and exchange them freely, in accordance with their needs. We believe that providing such a marketplace has helped to create the abundance of beef, pork, eggs, potatoes and other commodities that this nation enjoys.

Obviously, we feel there's a great future in what we do, for ourselves and for America.

That's why we're building.

CME CHICAGO MERCANTILE EXCHANGE
110 North Franklin Street, Chicago, Illinois 60606

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Five years ago, manual handling of transactions was virtually limited to about 5,000 per day. Expecting growth, Merc officials installed a computer for back office clearing operations, then went after more business. The business came in, but failed to glut the procedural pipes. Now, back office operations handle 20,000 and more trades daily with ease.

Promotion

Generation of business, too, has taken on a youthful vigor. About two years ago, an internal department of public relations and advertising was formed, with Ronald Frost becoming vice president. Under Frost, outside public relations counsel is coordinated, and a highly sophisticated advertising campaign carried on. New emphasis on advertising, alone, illustrates that the Merc hunts with heavy artillery: four years ago, a total of \$16,000 went for media advertising; for 1970, the budget exceeds \$500,000. Ads are whimsically hard-sell, with a creative approach more than a little like the famous Volkswagen campaign.

Summing up the past five years, Everette Harris admits that what the board and administrative staff accomplished was probably more difficult than had they started from scratch to build an exchange structure. "It's hard to break with what you have," he says. "You've got to consider many factors—people, opinions, various vested interests in the status quo. I'm sure we bit off more than we could chew many times." First the Merc had to departmentalize, Harris says. Departments which had traditionally shared many overlapping responsibilities were defined and given specific functions and responsibilities. Most departments have been expanded by a minimum of 50%, and they're still growing. Functions were delineated, then coordinated via scientific management principles until today, the exchange functions as a streamlined, well-oiled machine.

Nuts, Bolts and Buildings

Such smooth operational performance does not alter the fact that there always remains a good bit of tedious, nuts-and-bolts labor. Leo Me-

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lamed takes pride, and relief, in a small book on his shelves that represents 18 months of work: the new book of rules for the CME. Recently published, this set of by-laws (the result of 20 drafts), represents the combined work of scores of committees. "It was," Melamed says, "Our own little constitutional convention."

Perhaps the most dramatic event in Melamed's two years as head of the exchange was the announcement last year that the Mercantile Exchange was going to build a new headquarters building. Big and functional and five stories high, the new Merc will rise next to the 35-story Tishman-Gateway building now under construction on Union Station air rights. The CME has not owned its own quarters since the early 40's, when it "chose to get out of the real estate business."

The new site will house trading floor and administration offices. Broker and member facilities will be available in the adjacent tower building. According to schedule, the Merc will make its move early in 1973.

By that time, Leo Melamed, awarded his second term as chairman of the board by acclamation, will have served the allowed three consecutive terms. Someone else will be the Merc's helmsman.

And there may be a change in the contents of the gum ball machine. □