

TERRY SAVAGE  
TALKS MONEY WITH



LEO MELAMED

Leo Melamed will go down in history as the father of financial futures.

From his ceaselessly inventive mind and his unshakable belief in free markets, he has been the guiding force behind the Chicago Mercantile Exchange's leadership in creating global financial markets.

On a personal level, I am among countless people inspired by Leo Melamed to believe in our talents and in unlimited possibilities.

I first met Leo in the early 1970s, when I was a member and would-be floor trader on the Merc's International Monetary Market, which Leo created.

He was one of the few who never questioned that a woman could make it on the floor. And when television beckoned me, it was Leo whose reference assured the TV honchos that my comments could be trusted.

Along the way I frequently turned to Leo, not only for his views on the markets and the

economy, but for insight into the future. When the market crashed in 1987, and it was rumored that some firms might go under, dragging the financial system into chaos, it was Leo who let me know that the Fed had opened the money spigot to prevent disaster. The Fed chairman consulted with Leo, as well!

So it was with great anticipation that I sat down with Leo Melamed, the Merc's chairman emeritus, to discuss the current state of the markets—a conversation that was frequently interrupted as he jumped to answer calls from the trading floor, scanning the TV monitors as he bought and sold futures contracts. The action reminded me that Leo is a long-term thinker—and a very short-term trader.

**On the Merc**

"This is a 100-year-old market, but 30 years ago we were still the little agricultural exchange in

Chicago that traded stuff like pork bellies and eggs. And from that we transformed ourselves into this giant global market that covers the landscape of finance, and we still kept our agricultural products.

"We went into foreign exchange, interest rates futures, equity futures and options. And we launched the first electronic mechanism for trading called Globex."

**On open outcry**

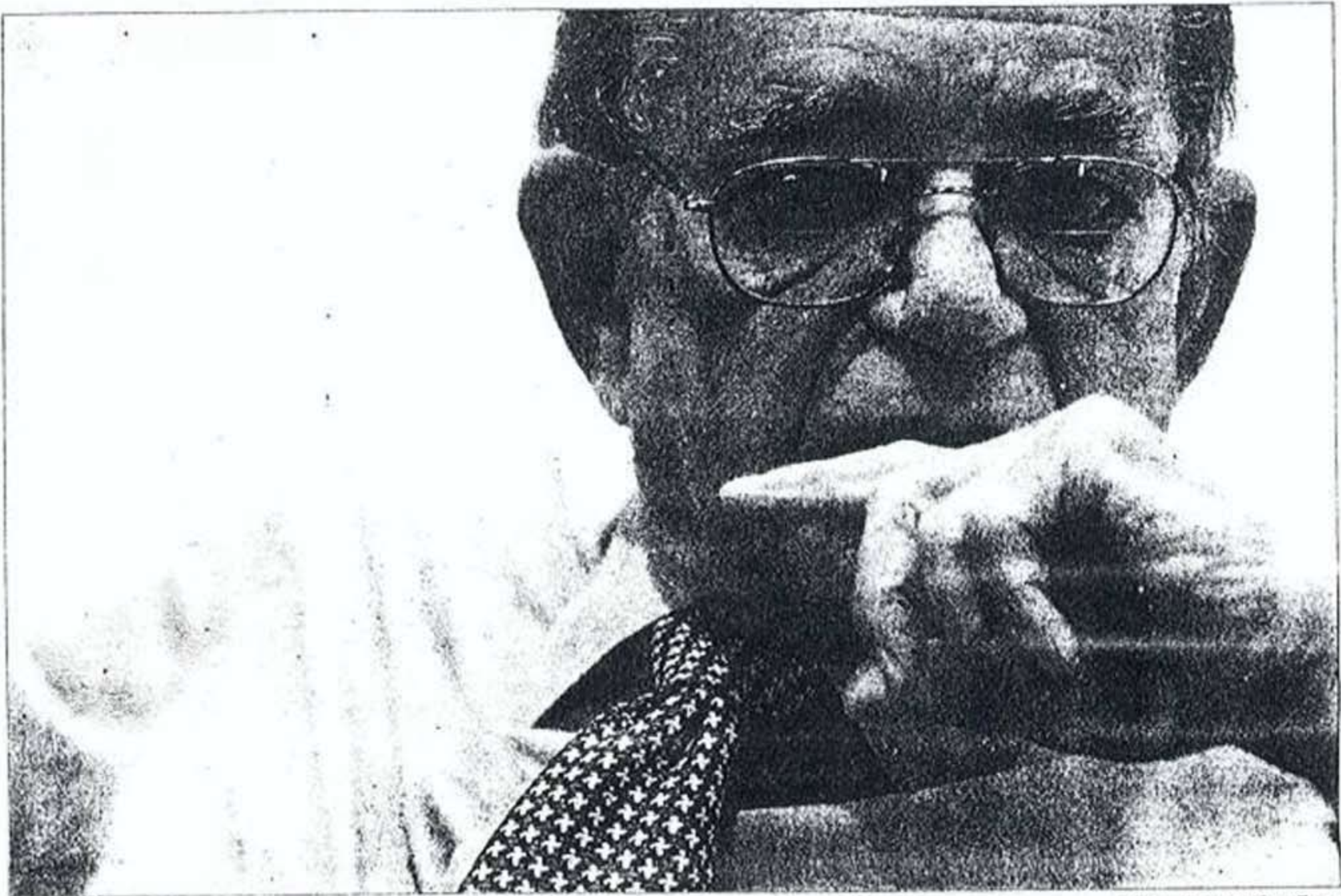
Melamed is widely credited for pushing the concept of electronic trading, even as it threatened to displace the livelihood of the floor traders who make their markets through open outcry and have always held the reins of power at the exchange.

"We were the very first exchange to develop the idea of an electronic mechanism to trade futures, though by the time it was



ROBERT A. DAVIS/SUN-TIMES

Leo Melamed in a photo from October 1998. Melamed is wildly enthusiastic about single-stock futures, which are to begin trading early next month.



BRIAN JACKSON / SUN-TIMES

**"What I found here was a country that gives everybody this enormous opportunity and the reason for this opportunity is that we have a genuine free market," says Leo Melamed.**

Born in Poland, Leo Melamed and his parents fled the Nazis in 1939 following the outbreak of World War II.

Miraculously, they outwitted both the Gestapo and the KGB as they trekked across Europe and Siberia to Vladivostok, the Eastern Russian seaport. As a result of a life-saving transit visa issued by Chiune Sugihara, the Japanese Consul General to Lithuania, the Melamndovich family left Russia and found safe haven in Japan.

In April 1941, they were admitted to the United States, and the family settled in Chicago, where Melamed's parents worked as Yiddish school teachers for the Sholem Aleichem Folks Institute.

Leo Melamed grew up on the Northwest Side of Chicago, attended Roosevelt High School, where he met his future wife, Betty Sattler, and completed his undergraduate studies at the University of Illinois at Chicago, and received his J.D. degree from the John Marshall Law School in 1955.

The Melameds have three grown children, Idelle, Jordan and David.

Leo Melamed was a successful Chicago attorney for a number of years but maintained part-time activities as a commodity futures trader. In 1965 he left the practice of law to concentrate full-time on a futures trading career at the Chicago Mercantile Exchange, where he conceived and created a futures market in financial instruments.

In 1972, Melamed's vision became reality when the International Monetary Market was launched, recognized as one of the most significant financial innovations of the 20th century.

Melamed has been an adviser to the Commodity Futures Trading Commission and serves as special adviser on futures markets to governments worldwide.

He is the author of several books and monographs on financial markets; a science fiction novel, *The Tenth Planet*, and his memoirs.

launched there were others doing it. We had to go to the floor [for permission], and the floor knew that this was the camel's nose under the tent. Our floor is a very educated group, very smart people. But they also knew that what we were telling them was the truth. We said, 'If this is the trend, don't we want to protect our franchise? Or do we ignore reality and die?'

"So we got an 87 percent favorable vote to go ahead in 1987 with electronic trading. Now this represented Darth Vader walking down the street. Nevertheless an enlightened membership voted in favor, knowing it had to do the right thing.

"So we said, 'We will make a deal. As long as open outcry pits continue to be viable, we will continue to support the pits, but we

don't want this to be a subjective test. We want this to be very, very objective. We will make a formula on which you can agree, an objective test—so much volume and so much open interest every year as a percentage of what the world trades in a given product. If you can maintain those minimums, we will continue to support you. But you've got to give us the right to do everything electronically we want to do, list everything side by side, so we don't lose those customers that want to do it electronically. Let the best man win, so to speak.'

"And the oddest thing has happened. Both markets have benefited."

## On the ultimate winner

"In the long run, I think it's

clear that electronics are going to rule the day, and someday all the markets will be operated in an electronic venue. But nobody knows when that's going to happen, and nobody knows which markets are going to move there more quickly than other markets.

"The only one that can make that decision is the marketplace itself. And so far, the marketplace has decided that a lot of the users still like the open outcry venue. As a matter of fact, that's the reason that our open outcry markets have grown along with the growth in electronic trading.

"I believe the ultimate outcome is electronic. I mean, the efficiencies are not comparable to what open outcry can provide, and the costs are much reduced. There's no

doubt in the long run the electronic market will be the only market.

"So why not find a way in which to bring our members along. Some of them don't care, some are too old and won't change. We can't do anything about them. But how about the 50 percent or greater factor of the younger members who can transform themselves into an electronic broker or electronic trader?"

"If we give them the tools, and we train them, and we spend some money in doing it, we will bring along those who want to come along. So that if, in fact, the destiny is electronic, as I believe it will ultimately be, we will have protected that resource, those members who are so expert, those members that produce the liquidity that is so necessary to maintain the marketplace.

"That's why we have created an electronic implementation committee doing all kinds of things in education and training to bring the pit broker into the electronic age. It started just last May, but a year from now, you're going to see those results. And I think it will be to the benefit of all those open outcry members."

## On the new Merc

In 2000, the Merc voted to "demutualize," to move from a member-owned, not-for-profit organization to a for-profit business. And the Merc has filed for an initial public offering of its shares in the next few months. Because of the upcoming public offering, Melamed is restricted from commenting about prospects for the future. But he does explain the forward-thinking change in structure in a conceptual way.

"Demutualization meant we became a for-profit organization instead of a mutual membership organization, and the board was given enormous new authority to proceed on its own judgment, and to retain outside management, people who hadn't necessarily been in the system a long time, but who know the marketplace, and who can give us leadership in the new directions we have to take.

"It's a very competitive environment for global market like ours, and it often requires very rapid action and quick decisions. A member organization requires a political process that takes time for educating the membership. Prior to demutualization we had 220 or

230 committees. We have about two dozen today."

There was another big reason for becoming a for-profit, shareholder-owned company.

"We know that to compete technologically, to make our Globex electronic system as good as it gets in order to compete with Eurex and LiffeConnect, well, that costs a lot of money! Technology is a very expensive thing!"

While Melamed couldn't comment on the IPO, the prospectus says the uses of the cash to be raised will include outlays for new technology.

## On single-stock futures

Melamed is wildly enthusiastic about the new product, futures on individual stocks. Single-stock futures are scheduled to start trading in early November, and several electronic exchanges have been formed to compete for market share. It was a prospect that finally drove the Chicago exchanges to work together to create OneChicago, an electronic exchange for single-stock futures.

"We knew we would face serious competition from Europe. LIFFE had already launched single-stock futures though they couldn't sell to Americans. Eurex was interested, the Amex was interested, as

well as the Chicago Board Options Exchange, the Board of Trade and NYMEX.

"And so here in Chicago evolved a kind of natural idea. We have both sides of the street: the CBOE expertise in options and single-stock options, and two of the largest futures exchanges. So we already had the clientele, so to speak.

OneChicago has refused to make its futures contracts "fungible" [interchangeable] with those traded on other proposed exchanges such as the exchange created by NasdaqLiffe markets. That means a contract bought on one exchange must be sold there as well. The exchange with the most market share wins. Melamed is very confident and very proprietary:

"When you spend the money and do all the innovations, and do the thought process and create the liquidity, what the hell do you want to give it away for?"

## On the stock market

"I'm afraid I'm not a believer that the bottom has been seen. I believe that the bubble that was built in the '90s was of such magnitude that its bursting is going to take a lot more of consequence than we've had.

"It may take another two to

three years before all the negative effects have been felt in all sectors, and that hasn't yet happened.

"So my view is that there is still pain out there, and I wouldn't get overly enthused with the present market. That's not to say markets can't rally. All markets rally and certainly bear markets have many rallies in the course of their destiny."

Melamed's wisdom transcends the markets, but it's always based on a belief in the free market. Here's what he's tried to teach his children and grandchildren.

## On grandchildren

"What you teach them is moral values, the right and wrong of things. And a belief in the free market. I believe that's basic to the success not only of this country, but an individual.

"If an individual really believes that his ideas and his career are dependent on himself or herself, then they can achieve. And in order to believe that, you have to believe in the free market.

"Nobody can achieve in an economy or a country that's dictated by prescription of government. Because then your potential is totally limited by what somebody else has prescribed for you.

"In a free nation, you write the prescription. Where do you want

to go? How much do you want to earn? What do you want to be? You make those decisions. And the marketplace will decide if you are right or wrong. But at least you have the opportunity."

## On starting out

Without education there is no future. You have to be educated to compete, whether in a job or as an entrepreneur.

Then, pick a niche. You can't be all things to everyone. Become an expert in one thing, and concentrate on what you really know. It should be something that fits your temperament and intellectual acumen. That's where you'll succeed.

"And I think you have to take some risk. It has to fit your temperament and pocketbook.

But some risk is advisable at an early age. Risk taking will get harder as the years go by. So if you're gonna do something that is a little—or a lot—risky you'd better do it early, so that if it fails, you can pick yourself up and start all over again—and still be a success at the end of the line.

"Take that risk, and hopefully it will work out. But if it doesn't, don't ever look back in terms of 'I could have ... should have ... would have.'"

"In life, at the time you make the decision, you have to believe that it's the right decision for that time, whether it turns out right or not. Don't be too hard on yourself if it doesn't work."

## On America's future

"I'm always bullish on America. You talk to an immigrant, and you find the greatest patriots on earth. This land saved our lives. While I came as a little boy, I never forgot that.

"What I found here was a country that gives everybody this enormous opportunity and the reason for this opportunity is that we have a genuine free market. The Milton Friedman ideals have been instituted more so here than anywhere in the world, and as a consequence this nation is more successful than any other in the world.

"Everybody throws daggers at us for all kinds of things, but if a vote were taken today where most people want to live, you'd have a line around the world coming here. So I can't be anything but a bull on America. Never mind the ups and downs of the stock market, this land will prosper!"

*Terry Savage is a registered investment adviser and is on the board of directors of McDonald's Corp. Send questions via e-mail to [savage@suntimes.com](mailto:savage@suntimes.com).*



Traders work in July in the Standard & Poor's 500 Futures pit at the Merc shortly after the opening bell. Leo Melamed says, "In the long run, I think it's clear that electronics are going to rule the day, and someday all the markets will be operated in an electronic venue." Electronic trading provides efficiencies that open outcry doesn't and much lower costs, Melamed says.