INTRODUCTION

The commodity trading system functions on a real time basis through online means. Farmers, exporters, importers, and traders are the main participants in this market. The commodity trading system operates through online channels. Trading takes place on a real time basis and is either routed through satellite communication system or the internet.

COMMODITY TRADING

Commodity trading is the market activity. It links the producers of the commodities effectively with their commercial consumers. Commodity trading mainly takes place in the commodity markets where raw or primary products are usually exchanged. The raw commodities here are traded on regulated commodities exchanges, in which they are bought and sold in standardized forms of contracts.

Trading Commodities trading is a sophisticated form of investing. It is similar to stock trading but instead of buying and selling shares of companies, an investor buys and sells commodities. Like stocks, commodities are traded on exchanges where buyers and sellers can work together to either get the products they need or to make a profit from the fluctuating prices.

COMMODITY TRADING MARKETS

Commodity markets are quite like equity markets. The commodity market also has two constituents viz.,

1. Spot Market : In case of a spot market, the commodities are bought and sold for immediate delivery. Spot trading is any transaction where delivery either takes place immediately, or with a minimum lag between the trade and delivery due to technical constraints. Spot trading normally involves visual inspection of the commodity or a sample of the commodity

2. Commodity Derivative Market : In case of a commodities derivative market, various financial instruments having commodities as underlying are traded on the exchanges. It has been seen that traditionally in India people have hedged their risks with Gold and Silver.

TYPES OF COMMODITY DERIVATIVE CONTRACTS

1. Forward Contracts : A forward contract is an agreement between two parties to exchange at some fixed future date a given quantity of a commodity for a price defined today. The fixed price today is known as the forward price.

2 Futures Contracts : A futures contract has the same general features as a forward contract but is standardized and transacted through a futures exchange. Commodity future is a derivative instrument for the future delivery of a commodity on a fixed date at a particular price. The underlying asset in this case is a particular commodity. The future date is called the contract expiry date. The fixed quantity is called the contract size. These futures can be bought and sold on the commodity exchanges.

3. Hedging : Hedging, a common practice of farming cooperatives insures against a poor harvest by purchasing futures contracts in the same commodity. If the cooperative has significantly less of its product to sell due to weather or insects, it makes up for that loss with a profit on the markets, since the overall supply of the crop is short everywhere that suffered the same conditions.

PATTERNS OF TRADING

There are different patterns for trading of commodities:

Independent: A trader can open his own account and manage it without a commodity broker but he will have his own responsibility of managing funds, placing orders, maintaining margins and understanding the market as to which direction the price is moving.

Managed Account: In this pattern of trading, an investor/ trader can open an account with a broker and explain to the broker the kind of trading he is interested in. The broker carries out the instructions of the investor.

Commodity Fund: A person can join a commodity fund which is like a mutual fund. The commodity fund is a group of commodities in which a person can invest his money. It is a group account but traded as one account. The profits and losses are proportionately dependent on the amount of money which is invested in the fund. The funds should be managed by a good broker because the futures market is considered to be very risky.

Electronic Trading: All trade takes place through electronic trading which is a transparent means of trading of commodities. Electronic trading takes place through trading terminals. The orders are matched on price and time priority and are conformed at the terminal. The unmatched orders remain in the system until they are matched or withdrawal. When the trade is finally executed, all those who were participating will receive the last price and the quantity data as well as information on the offer, size of each other and the best bid.

SIZE OF THE COMMODITY MARKET

1.Size of Global Commodity Markets

The trading of commodities includes physical trading of food items, Energy and Metals, etc. and trading of derivatives.

(i) In the five years up to 2007, the value of global physical exports of commodities increased by 17% while the notional value outstanding of commodity OTC derivatives increased more than 500% and commodity derivative trading on exchanges more than 200%.

(ii) Agricultural contracts trading grew by 32% in 2007, energy 29% and industrial metals by 30%.

(iii) Precious metals trading grow by 3%, with higher volume in New York being partially offset by declining volume in Tokyo.

2. Size of Indian Commodity Markets

(i) Commodity Markets have their presence in country for over 120 years.

(ii) Trade in commodities has been Unorganized in Regional markets and Local Mandis.

(iii) Trading in Futures Contracts has been permitted in over 120 commodities.

(iv) Physical commodity market size in India is estimated to be. a:round 25 lakh crore per annum.

(v) Major commodities traded in India are Gold, Silver, Crude Oil, Copper, Guar, Chana, Spices, among the few.

(vi) Ban in forward trading from mid-sixties

(vii)Prior to ban

- Thriving commodity exchanges for cotton, gold, edible oils etc.
- More than 20 regional commodity specific exchanges

(viii)Recent developments

- Ban completely lifted in 2003
- Emergence of national level de-mutualised online multi-commodity exchanges
- 3 National and 21 regional exchanges
- Trade in 60 commodities compared with just 8 in 2000

Steps for trading in commodity futures to be followed by the investor:

Step One: Choosing a Broker

Step Two: Depositing the Margin

Step Three: Access to Information and a Trading Plan

Step One: Choosing a Broker

The broker you choose should be a member of the exchanges you wish to trade in. Other than this, one should keep the following factors in mind while choosing a broker: . ’

(i) Competitive edge provided by the broker.

(ii) Broker’s knowledge of commodity markets.

(i) Credibility of the broker
(ii)Experience of the broker.
(iii) Net-worth of the broker.
(iv) Quality of brokers trading platforms.

Step two: Depositing the Margin

To begin trading, the investor needs to deposit a margin with his broker. Margin requirements are of two types, the initial margin and the maintenance margin. These margin requirements vary across commodities and exchanges but typically, the initial margin ranges from 5-10% of the contract value.

The maintenance margin is usually lower than the initial margin. The investor's position is marked to market daily and any profit or loss is adjusted to his margin account. The investor has the option to withdraw any extra funds from his margin account if his position generates again. Also, if the account falls below the maintenance margin, a margin call is generated from the broker and the investor needs to replenish his account to the initial level.

Step Three: Access to Information and a Trading Plan

As commodity futures are not long-term investments, their performance needs to be monitored. The investor should have access to the prevailing prices on the exchanges as well as market information that can help predict price movements Brokers provide research and analysis to their clients. Other information sources are financial dailies, specialized magazines on commodities and the internet. Further, an investor requires a trading plan. Such a trading plan can be developed in consultation with the broker. In any case, the investor has to remember to ride his profits and cut his losses by using stop loss orders

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