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Additional Reading Materials
on
Gold Futures Contract

Relevant for

1. **Module 14 (Futures and Options)**

2. **Module 18 (Securities and Derivatives Trading [Products and Analysis])**

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(This document consists of 9 pages including the cover page)

Topic Outline

1. Introduction to Gold Futures (FGLD) Contract

Gold futures (FGLD) contract is an agreement to buy or sell gold on a future date at an agreed-upon price. FGLD is a small-sized Ringgit Malaysia (“RM”) denominated gold futures contract traded on Bursa Malaysia Derivatives, providing market participants exposure to international gold price movements at a lower entry cost.

The pricing of the FGLD contract in local currency removes the need for Malaysian participants to purchase foreign currency when entering or exiting the market. Each FGLD contract is equivalent to 100 grams of gold bullion. The small size has been designed to provide accessibility to all and also flexibility for those wanting greater exposure. For the retail player wanting a smaller exposure, the small size provides affordability. For the industrial user requiring a larger exposure, the contract can be traded in multiple lots at a time (e.g. 5 lots, 10 lots etc.).

As a cash-settled contract, no delivery of physical gold is required. Instead, the FGLD contract will be settled on expiry using the cash equivalent of the amount of gold purchased (e.g. 100 grams), calculated using the London AM Fix price (in USD) on the final trading day converted into Ringgit Malaysia. The London AM Fix price is the global benchmark for spot gold prices and the settlement of the FGLD contract in accordance with this price characterises the FGLD contract as an instrument that tracks the international gold market closely.

Similar with other commodity contracts, FGLD can be used for hedging, speculating and arbitrage. Besides FGLD, other commodity futures available on Bursa Malaysia Derivatives include crude palm oil futures, crude palm kernel futures and USD crude palm oil futures[1].

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[1] *Refer to Topic 4.04 of the Examination Study Guide for Module 14: Futures and Options for more information on commodity futures*

2. Contract Specifications for (FGLD)

Contract specifications may vary from time to time. The table below is an example and will be used as the basis in the following exercises. You can refer to the Bursa Malaysia website at www.bursamalaysia.com for the latest contract specifications.

Table 1: FGLD Contract Specifications

Contract Code	**FGLD**
Underlying Asset	Based on London Fix Gold Specifications
Settlement Method	Cash Settlement
Contract Size	100 grams
Price Quotation	Ringgit Malaysia per gram
Minimum Price Fluctuation	RM 0.05 per gram (or RM5 per tick)
Daily Price Limit	There must be no trading at a price more than 10% above or below the settlement prices of the preceding Business Day ("the 10% Limit") except as provided below: a. If spot month Contract trades at the 10% Limit, the Exchange will announce a 10-minute cooling off period ("the Cooling Off Period") for Contracts of all contract months (including the spot month) during which trading may only take place within the 10% Limit for Contracts of all contract months (including the spot month). b. After the Cooling Off Period, Contracts of all contract months (including the spot month) will be specified as interrupted for a period of 5 minutes, after which the price limit will be expanded to 20%. The prices traded for Contracts of all contract months (including the spot month) must then not vary more than 20% above or below the settlement prices of the preceding Business Day ("the 20% Limit"). c. If spot month Contract trades at the 10% Limit less than 30 minutes before the end of the first trading session, the 10% Limit will apply to Contracts of all contract months (including the spot month) for the rest of the first trading session, and the 20% Limit will apply to Contracts of all contract months (including the spot month) during the second trading session. d. If spot month Contract trades at the 10% Limit less than 30 minutes before the end of the second trading session, the 10% Limit will apply to Contracts of all contract months (including the spot month) for the rest of the Business Day. e. On any Business Day other than the Final Trading Day, the price limits in the above paragraphs apply to trades in Contracts of all contract months including the spot month. On the Final Trading Day, the price limits in the above paragraphs do not apply to

	trades in spot month Contracts.
Speculative Position Limit	The maximum number of net long or net short positions for all months combined which a client or a participant may hold or control is 25,000 contracts.
Trading Hours	Monday to Friday **Trading Sessions:** (Malaysian Time) 0900 – 1230 hours 1430 – 1900 hours **Business Days:** Follow KL Business Days
Contract Months	Spot month; and Next 3 calendar months; and Any February, April, June, August, October and December falling within a 12-month period beginning with the spot month.
Final Trading Day	Last common Business Day of the spot month in both London and KL. *Notes:* *If the last Business Day of the spot month is a holiday in London, the Final Trading Day will be the first preceding Business Day that is not a holiday in London.* *A new contract will be available for trading on the first KL Business Day of the following month.* *Apart from the expiring contract, all other contracts continue to trade up to the last KL Business Day of each calendar month.*
Final Settlement Value	The Final Settlement Value will be calculated using the London Gold AM Fix (quoted USD/troy oz) on the Final Trading Day adjusted for conversion into RM/gram. **USD/RM conversion rate** 1700 hours middle rate published on the Final Trading Day on the Bank Negara Malaysia website. **Conversion from Troy Ounce to Grams** 1 troy oz = 31.1034768 grams. **Rounding Up/Down** Final Settlement Value to be rounded to the nearest RM0.05.

3. Trading FGLD

Gold futures are traded by those who wish to assume the price risk that hedgers try to avoid in return for a chance to profit from favourable gold price movements. They will buy gold futures when they believe that gold prices will increase and will sell when they think gold prices will fall.

The following are some working examples for hedging and speculating with gold futures.

i. Protection of asset value *(Selling Hedge)*

Mr Eddie, a gold coins collector has amassed 2,000 grams of gold coins over the years. He believes that gold prices is going on a downtrend and he wishes to use FGLD contracts to protect the value of his asset. Assuming that the FGLD is currently trading at RM140.00 and there is no transaction cost.

For a full hedge, Mr Eddie would need to sell 20 FGLD contracts (2,000g/100g) at RM140.00 to protect his current physical gold coins portfolio. The contract value from the sale would be RM280,000 (RM140.00 x 100g x 20 contracts).

Assuming that gold prices fall to RM130, the value of Mr Eddie's portfolio will fall to RM260,000 (RM130.00 x 2,000g). This represents an unrealised loss of RM20,000 (RM280,000 – RM260,000). However, Mr Eddie would have made an equal profit of RM20,000 when he closes out his futures position (i.e. buy 20 FGLD contracts at RM130).

Sell 20 FGLD contracts at RM140 (RM140 x 100g x 20 contracts)	RM280,000
Buy 20 FGLD contacts at RM130 (RM130 x 100g x 20 contracts)	(RM260,000)
Profit from FGLD	RM20,000

Using FGLD, Mr Eddie can protect the value of his gold coins in the event of a fall in the gold prices.

ii. Locking in current gold price *(Buying Hedge)*

A goldsmith who requires gold to produce jewellery can buy FGLD to lock in the price of gold today if he believes that the price will increase in the future.

Below is an example of a buying hedge; transaction costs are excluded:

Quantity of gold to be hedged	= 4,000g
FGLD price	= RM150

The goldsmith would need to buy 40 FGLD contracts for a full hedge (4,000g/100g). If the FGLD rises to RM160, the profit for the above trade is as follows:

Buy 40 FGLD contracts at RM150 (RM150 x 100g x 40 contracts)	RM600,000
Sell 40 FGLD contracts at RM160 (RM160 x 100g x 40 contracts)	(RM640,000)
Profit from FGLD	RM40,000

Assuming the gold price is RM160 per gram, the goldsmith would need to pay RM640,000 to obtain 4,000g of gold. Taking into consideration the profit from FGLD, his effective price is RM600,000 (RM640,000 – profit of RM40,000) or RM150 per gram (RM600,000/4,000g).

From this example, the goldsmith can use FGLD to lock in the current gold price in the event of upward price movement, where profits from FGLD contracts are added to his working capital to purchase the gold required.

iii. Taking advantage of gold price volatility *(Speculating)*

An investor is interested to include 2,000 grams of gold as an asset class in his investment portfolio. He observes that gold prices have been volatile and believes that he can profit from the price fluctuations. Currently the gold price is at RM140 per gram.

If the investor expects that gold price will increase to RM150 per gram, he can profit from this situation by executing the following trades assuming there is no transaction cost.

Buy 20 FGLD contracts at RM140 (RM140 x 100g x 20 contracts)	RM280,000
Sell 20 FGLD contracts at RM150 (RM150 x 100g x 20 contracts)	(RM300,000)
Profit from FGLD	RM20,000

If the investor expects that the gold price will fall to RM120 per gram, he can profit from this situation by executing the following trades assuming there is no transaction cost.

Sell 20 FGLD contracts at RM140 (RM140 x 100g x 20 contracts)	RM280,000
Buy 20 FGLD contracts at RM120 (RM120 x 100g x 20 contracts)	(RM240,000)
Profit from FGLD	RM40,000

From this example, the investor can use FGLD to diversify his investment portfolio and profit from the fluctuation of gold price.

4. Summary

The gold futures contract provides market participants with more trading and investment opportunities by introducing a new asset class: precious metals. In addition, it also serves as a risk management mechanism for the primary user of gold such as jewellery makers.

Speculators could take advantage of the volatility in gold prices by entering into FGLD trading. The speculator can buy the FGLD contract if they expect the gold price to increase and sell the FGLD contract if the gold price is expected to fall.

Goldsmiths, a primary user of gold can use the FGLD contract to hedge against unfavourable price movements to minimise the production cost of making jewellery. If gold prices are expected to increase, the goldsmith can sell FGLD contracts to lock in the current gold price.

Practice Questions

Question 1

Which of the following statements with regard to the gold futures contract is TRUE?

(A) Final settlement value must be rounded to the nearest RM1.00

(B) Minimum price fluctuation is RM0.05 per gram or RM5 per tick

(C) Delivery of physical gold is required upon settlement of the contract

(D) Final trading day is the common business day of the spot month in Chicago and Kuala Lumpur

Question 2

Eddie has 6,000 grams of gold in his investment portfolio. How many FGLD contracts are required to fully hedge his portfolio against downward movement of gold prices?

(A) 12 contracts

(B) 60 contracts

(C) 120 contracts

(D) 600 contracts

Question 3

A speculator observes that the price of gold has been volatile and believes that he can make a profit from this situation by trading a gold futures contract. Currently, the gold price is RM150 per gram. If the speculator expects that the gold price will increase to RM155 per gram, how much is the expected profit of the futures contract? (Assuming no transaction cost)

(A) RM250

(B) RM500

(C) RM5,000

(D) RM15,500

Answer

1. B 2. B 3. B

Reference: *Bursa Malaysia:* www.bursamalaysia.com