SM122 | 5.20.2023
Days of Futures Past | Episode 2
John Lothian, Founder & Publisher of John Lothian News

In the second installment of our *Days of Futures Past* series, we welcome John Lothian into the SmarterMarkets™ studio. John is Executive Chairman at John J. Lothian & Company and Founder & Publisher of John Lothian News. SmarterMarkets™ host David Greely sits down with John to discuss the people and times that created the modern futures exchange in Chicago.

John Lothian (00s):
The integrity of the markets is really important, but we all have responsibilities for that. And so I think that if the markets can keep their integrity, that we'll all do well.

Announcer (13s):
Welcome to SmarterMarkets. A weekly podcast featuring the icons and entrepreneurs of technology, commodities and finance ranting on the inadequacies of our systems and riffing on ideas for how to solve them. Together, we examine the questions: are we facing a crisis of information or a crisis of trust, and will building Smarter Markets be the antidote?
This episode is brought to you in part by Abaxx Exchange, bringing you better benchmarks, better technology and better tools for risk management.

David Greely (54s):
Welcome back to Days of Futures Past on Smarter Markets. I'm Dave Greely, Chief Economist at Abaxx Technologies. Our guest today is John Lothian, Executive Chairman at John Lothian and Company and Founder and Publisher of John Lothian News. We'll be discussing the people and times that created the Modern Futures Exchange in Chicago. Hello, John. Welcome to Smarter Markets.

John Lothian (01m 17s):
Thank you for having me.

David Greely (01m 19s):
Oh, absolutely. The modern history of commodity futures exchanges is often written in terms of impersonal forces of economics and history, but to you, it's very much a story of people and places you've chronicled the people and development of the Modern Futures Exchange in Chicago. So I'm really happy to get you here today to share your perspective and some of your stories with us. And my first question to you would be, when and with whom does the story of the modern commodities futures markets begin for you?

John Lothian (01m 51s):
Well, actually, I went to work for a gentleman by the name of Tom Cashman when I was 17 years old, but it really begins with him and his family because during World War II, the markets had price controls on them, and the only market that didn't have a price control on it was lard and the Board of Trade was trying to reestablish its narrative and its story, and because the prices, you know, weren't moving and there wasn't volatility, the price of memberships had come down and so it allowed people to come in and buy memberships that were not as rich as before the war or whatever. And that was many immigrants and that included Tom Cashman's family and there's a great story about how his grandparents had had a house on the west side of Chicago that the city of Chicago wanted for the Eisenhower Expressway, and the city bought it, and they gave the family a check.

John Lothian (02m 58s):
And there was, I think, eight family members sitting around the table. The parents had passed away and, and so the kids were trying to decide what to do with the money and would they all give, you know, a little bit to each family member, or would they give the money to the oldest brother George, who had been a runner at the Board of Trade and allow him to become a member of the exchange, which is what they did. And slowly he brought several of his relatives into the exchange. And at one time there were 14 different Cashmans and 14 different trading pits at the Board of Trade. And so, you know, it's a great family story about how all these different immigrant families, risk takers, people that came into the markets, you know, were able to participate in them.

David Greely (03m 53s):
And the story really began, as you said, in that relatively quiet period following price controls and low volatility after the second World War. But if we kind of move forward to the 1970s, that was a period that was truly transformative for the futures markets. You know, looking back at the beginning of the decade, futures were for physically deliverable commodities exclusively, I believe and by the 1980s, futures were trading on currencies, US treasuries, Euro, dollars, and stock indices. There were certainly external forces at work. Volatility came roaring back into the markets with the dismantling of the Bretton Woods currency system. Nixon moved the US off the gold standard. There was the formation of OPEC and the oil shocks, the US embargo on selling wheat to Russia and inflation. So lots of risk needing to be managed. I'd love you to walk us through some of the people and events that shape that transformative decade. You know, maybe we can start off with the creation of currency and bond futures.

John Lothian (04m 54s):
So, before Bretton Woods broke up, there was actually a guy in New York that approached the New York Produce Exchange. His name was Murray Borowitz and the New York Produce Exchange had fallen on hard times because of a scandal, this great salad oil scandal of the 1960s, okay. And because of that, they were looking for new things to trade. And so Murray suggested currency futures. And so they listed currency futures and they made him the executive chairman of the exchange, and they renamed the exchange, the International Commercial Exchange. So it was the first ICE before Intercontinental Exchange. And you can actually go on the CFTC website and see that they were the first, you know, financial futures exchange. However, when they went to deliver the Japanese Yen Futures for the first time, the Japanese Central Bank would not let the currencies out of the country. And because of that, the contract failed and ultimately the exchange failed, and it got rolled into the New York Mercantile Exchange, which is part of the Chicago Mercantile Exchange of the CME group today.

John Lothian (06m 07s):
And then part of their history. Now, Leo Malamed had seen that, you know, there was an opportunity to trade these futures, these currencies. And so he created the International Monetary Market in Chicago as a separate exchange, and he sold memberships to everybody that he could find. And it became a successful thing. And it, then they rolled that back into the Chicago Mercantile Exchange, and so it became a division of the Chicago Mercantile Exchange. That was just one of several divisions that they had. When they later developed the stock index features, they created the IOM, the Index and Option Market Division, which was another one. But the currencies, you know, was Leo's baby. And he stood there and asked people to go over and trade them for five minutes a day or 10 minutes a day, or 15 minutes a day, you know, go make a trade.

John Lothian (07m 10s):
And they would, until they finally, you know, caught fire and became a, a big success. Now on the Bond futures, the first contract was actually the Ginnie Mae Futures. And so the Ginnie Maes were started and they failed about five different times. There were about five different versions of the Ginny May contracts before they finally gave up at the Board of Trade. But that was the first interest rate contract, both the Board of Trade and the C M E would list TBI Futures, although it was the CME that finally succeeded in having a TBI futures contract. The Board of Trade then developed a T Bond Futures contract in 1977, and that became the most traded futures contract of the 20th century, more than any other futures contract and it was just a thing to behold. So when that first started, they traded the bonds and the Ginny May in what was called the South Room of the Chicago Board of Trade.

John Lothian (08m 18s):
And then it became so big that they built a new trading room for the grains in 1981, and they moved the bonds into the 1929 trading floor of the Board of Trade and they put the bonds in the old soybean pit and it was just packed to, just packed. There was something to behold in, in there and that room was kind of interesting because back in the day when it was trading grains, they had these beautiful windows that looked down LaSalle Street, you know, so that you could see out the windows and see whether it was raining or not but when it was the financial room, they painted him black. So it was kind of a dark and dingy room in there and, and all, so it was a little bit different, but they subsequently developed 10 year nodes, five year nodes, two year nodes at the Board of Trade and developed the whole curve there and it became a very, very active, you know, interest rate complex for the Board of Trade.

David Greely (09m 31s):
And you know, what we've been talking about so far are mainly futures contracts. And at the start of the 1970s, there were really only futures at the end of the decade. We talked in terms of derivatives and of futures and options. And I was hoping you could walk us through how did the options markets develop in Chicago?

John Lothian (09m 50s):
Well, the equity options markets started because in the late 60s, the guys at the Board of Trade were kind of bored because the markets weren't moving around very much and so they were looking for something to trade and a guy by the name of Eddie O'Connor came up with the idea of trading equity options as a listed contract. At the time, equity options were only traded over the counter out in New York and so the Board of Trade started a committee and it was actually run by a guy named of Bill Mallers Sr., who was a former employer of mine and so they developed the idea for what became the Chicago Board Options Exchange, and they set it up as a separate entity because they did not want the Board of Trade to be regulated by the SEC. That was a recurring theme in Chicago that the exchanges did not want to be regulated by the SEC.

John Lothian (10m 55s):
The Board of Trade actually had a securities license many, many years before where they could have traded stocks, but they didn't do anything with it but anyway, they set up the CBOE as a separate entity. You know, at one point the old time grain firms kind of were complaining like, hey, we're never gonna trade, you know, on this thing. We need to, you know, really stop the bleeding and so that they kind of forced them to stand on their own two feet and, you know, they sold a lot of memberships to fund themselves and, and they, they got going, there was a lot of pushback from the SEC about it, but they, they worked their way through it and they finally launched, it was 50 years ago that they launched April 26th 1973 and they traded 911 contracts on the first day.

John Lothian (11m 50s):
And interestingly, it was the SEC only allowed them to trade calls because puts were not needed. It wasn't until about, you know, several years later that they were able to push through to be able to get puts, which really made the product more, more fully functional but it wasn't until the mid 1980s that options were allowed to trade in the futures markets. They had been outlawed in the futures markets and I can't remember exactly what was that, freed them up, but all of a sudden we had options on soybeans and corn and wheat and then the treasury bonds and over at the Mercantile Exchange, they hired a guy by the name of Bill Brodsky from the Amex to come in. He eventually became the CEO of the exchange and when he joined the exchange, the CME didn't have options on their futures contracts and when he left the exchange to become the, the CEO of the CBOE, they had options contracts on every single contract over at the CME.

David Greely (13m 08s):
Well, and it's a great story with CBOE and we're gonna have guests from CBOE on later in this series to dive into it more deeply. One thing I wanted to ask you about is, there was also interesting support coming in from the academic community as well. I mean, obviously in 1973 you had the development of the Black-Scholes option pricing model. I believe Richard Sandor played quite a role in the development of the exchanges in the 1970s as well. Can you tell us a little bit about his story?

John Lothian (13m 38s):
Yeah, so Richard Sandor was a kid from New York who had been out at Berkeley as a professor. He was recommended for a job at the Chicago Board of Trade as the Chief Economist. He had done some work on some banking stuff and so they invited him in for an interview. Anyway, he ended up getting the, getting the job. His wife tells a great story about how he got interviewed at the Union League Club and he, and she walked into the Union League club and she was told that she couldn't walk in through the front door because she was a woman, and she said the heck with that and walked right through the front door and so he was sure that he was never gonna get that job, but sure enough he did and so that was the first time that the Board of Trade had a chief economist.

John Lothian (14m 38s):
And, and so he worked to kind of rework some of the agricultural contracts that they had and then he worked on the, the Ginny May contract. He got a bunch of data from bank out in California and looked at their portfolio and you know, kind of worked on that and so he worked on that and then and then he and his team that he developed at the Board of Trade developed the 30 year bond contract there as well. So it wasn't just him, but it was a team of people that he built there at the Board of Trade that developed these contracts and you know, really kind of changed the nature of it. But one of the, one of the big things that that changed was all of a sudden you had financial features, contracts and the futures industry had always been regulated by the agriculture department.

John Lothian (15m 45s):
And so that wasn't gonna work in Washington and so the exchanges went to Washington to say, hey, we need a new structure for this and also at the same time, the big banks the big brokerage houses, the wire houses went to Washington and said, hey, we need a new structure for the brokerage industry because during the 1970s when you had the big run up in, in wheat prices and soybean prices and

all that, a lot of these wire houses, which had, you know, two men operations out in the middle of nowhere, there'd been some customer abuses and it was the wire houses that got sued, the ones with the deep pockets. And so they wanted to prevent that from happening again and so you had the creation of the Commodity Exchange Act, which created the Commodity Futures Trading Commission and with that, then you had the Senate Banking Committee that had oversight over the CFTC as well as the Agriculture committee.

John Lothian (16m 54s):
And so you had this kind of dual regulation oversight there but because of that, you know, you had these new contracts that were allowed to trade and be approved by the CFTC. That also was the creation of futures commission merchant model, where you have different types of what are called FCMS and then the introducing broker model where you have independent IBS and guaranteed IBS and that actually was what cost me my first job was when that all happened because a lot of the brokerage firms fired all their branch offices and when they did that, they pulled a lot of news machines out and I was working for a news organization at the time, and so they let some reporters go and I was one of them and so that always kind of stuck with me is to, as an important thing to pay attention to the, the big macro view of what was going on.

John Lothian (18m 00s):
But that regulatory change allowed a lot of innovation to occur within the industry. Not only did the, did the industry get the creation of the CFTC to look over it, but it also then allowed for the creation of the National Futures Association, which was a self-regulatory organization and this was a little bit different than the security side set up and so the NFA is a body that is got a bunch of people from the industry, from the exchanges and the brokerage firms that kind of, you know, regulate the industry hires a bunch of professionals and that do all the audits and, you know, look out for abuses and, and find, but it's, it's the people that they, they look after the people that are registered, you know, and so they can only find and deal with those people, whereas the CFTC has the rest of the world. They're looking out for the bad guys, you know, in the, in the rest of the world and the CFTC has always been kind of this underfunded agency in, in Washington and so it's, it's been a hard trek for them in, in a lot of ways, but that innovation led to a lot of new contracts and new exchanges and all through the years.

David Greely (19m 21s):
Yeah and the innovation on the regulatory side, I wanted to delve into that a little bit more deeply with you as well, because not only were we adding options markets, but the, the nature of futures contracts changed as well with more and more financial futures, the growth in that area. So in addition to physically settled contracts, now there were cash settled or financially settled contracts and futures contracts on indices, which had to have been a really new idea at the time. These developments enabled the new futures markets in Euro dollars and equity index futures like SMP, 500 futures, things that are very commonplace today. I was curious, how did, how did these innovations come about of moving into cash settled contracts moving into futures on indices?

John Lothian (20m 07s):
Well, back in the early 1980s, there was a move to launch Stock Index Futures, the Board of Trade, which at the time was the largest futures exchange, not only in the US but in the world. So just to keep a perspective on this, when I entered the industry back in the seventies, the board of Trade was the largest exchange in the world. Not only were they more than 50% of the world's futures volume, but their volume went up every year, right and so they wanted to list that Dow Jones Index as a futures contract and they didn't want to pay for it, they just thought that it was public information and they could go ahead and do that. Well, the Dow Jones people had other thoughts on that. And so they sued the Board of Trade, the CME wanted to also list the Dow Jones, but they were smart enough to realize that, not to get in the middle of a match.

John Lothian (21m 05s):
And so they looked for other things and it was suggested to them to talk to the people over at Standard and Pores and at the time kind of little known SMP 500 contract and so they did, and they signed an agreement for the SMP 500, the people in Kansas City, at the Kansas City Port of Trade. They did a deal with the, the value line people for a contract, the value line and the New York Stock Exchange wanted to get into the business. They created their own features exchange, which was at the time thought to be a potential real competitor with the Board of Trade. They were gonna list treasuries and they were gonna do some other things, but they created the New York Composite Index and some other, some other indices, with the New York Financial Exchange Index or something like that the knife.

John Lothian (22m 02s):
And they eventually sold that to what became the New York Board of Trade, but anyway, the issue for the regulators was how to be able to create these contracts and when the CME applied for it, they were talking to the CFTC, which was led by a guy by the name of Johnson at the time and the SEC was led by a guy name of John Chad at the time, and they were having discussions and part of it was who had the regulatory oversight over stock index futures because the SEC said, hey, these are stocks, these are ours and so they came up with an agreement that said, if it's a narrow based indices, it belongs to the SEC and if it's a broad based indices like the SMP 500 or anything more, you know, with more than say 15 stocks in it, then that is a CFTC product, a broad-based indices.

John Lothian (23m 09s):
And okay but part of that deal was that they also outlawed single stock features because they couldn't agree on, on that one. So they just outlawed them and then John Chad came back to the CFTC and he said, hey, my guys tell me that it's too difficult to settle these contracts physically, so they'll have to be cash settled and cash settlement had been kind of outlawed since about the 1920s or 30s. There was a famous court case where a gambler had taken a huge position at the Board of Trade and lost and left a huge debit and had been sued and he said, hey, I don't have to pay these, pay this because it's gambling, it's gambling debts and it, so I don't have to pay this and the court found that any contract that includes the possibility of delivery is a futures contract, which is legitimate.

John Lothian (24m 23s):
And if it's just cash settled, then it's gambling and so that was the onus that was on these cash settlement contracts for all these years and so now the, the SEC giving its blessing for cash settlement allowed this to happen and so he went to Johnson and Johnson went to the CME and said, hey you guys, we are going to let you do this, but you got to do it with cash settlement but that actually caused the CME to have to reapply for their SMP 500, which meant that the value line was the first in line because I think they had applied for cash settlement and so the first contract that was approved was actually the Kansas City value line and then the SMP 500 and then the other, other contracts.

John Lothian (25m 18s):
Meanwhile the port of trade after the CME was having some success with this contract, finally figured out that there were a bunch of idiots and even though they continued on with their lawsuit at against Dow Jones and they finally lost it, they created a contract called the Major Market Index, which essentially was the Dow Jones Industrial 30 with about three different contracts in it and so it had about a 97% correlation to the Dow Jones and they played around with that for a few years before they finally got the right sizing for it and all that kind of stuff. But it was never a, never a major player except during the 87 stock market crash when it was the only market that was really open for trading and it was Blair Hall that went into the market and started to make a market and bid for the market and turned the market around.

John Lothian (26m 18s):
And that was in the, in the blue chip contract. But the cash settlement got approved there, which then allowed the creation of the Euro dollar contract, which was another contract that the CME came up with. So Euro dollars are deposits of US dollars at European banks and so if you think about it, what was happening was we were paying a lot of money to Middle Eastern countries for, for oil. And they were taking the money and they were sticking it into European banks and they were dollar deposits because that's how they got paid for the crude oil and then the banks were paying them in interest rate on that and so people needed to hedge this, this rate and so the CME created a short term interest rate, and it was kind of like a TBI rate, except that it didn't have the full faith and guarantee of the US government backing, it had the backing of the bank.

John Lothian (27m 20s):
So then it became kind of a, a credit risk trade. So there was a trade called the TED spread where you bought the T-bills and you sold the Euro dollars because you were afraid of risk in the marketplace and people still trade the, the TED spread, but they traded the two years versus the Euro dollars or something like that, you know, today kind of thing but the TED spread was a hugely popular trade back, back in the day when the T-bills were, were still trading before they kind of just dried up. But yeah, so the cash settlement allowed the creation of Euro dollars, which became one of the most popular contracts. It became the most liquid one in terms of the largest open interest after 2000 and really put the CME on the map as a major player and, and as a features, you know, exchange.

David Greely (28m 20s):
Yeah, I mean it's really amazing, taking a step back, how much innovation came out of one place in one decade in the city of Chicago and I wanted to ask you, cause I'm curious about an important development that was more in the 1980s that didn't happen in Chicago,

the creation of the modern energy futures markets, the energy markets developed largely outside Chicago NYMEX, the New York Mercantile Exchange, now owned by the CME Group, obviously in New York and the International Petroleum Exchange now owned by the International Continental Exchange in London and I'm curious, why do you think the energy markets didn't develop in Chicago?

John Lothian (29m 00s):
Well, actually there was a contract at the Board of Trade that was listed for crude oil futures, I want to say the CME may have listed a contract as well, but each one of them had to kind of pick a delivery spot for where they wanted the, the delivery to be and I think the Board of Trades contract delivered it to like New York Harbor or something like that and the NYMEX contract delivered it to some remote spot in the middle of Oklahoma or something like that and that was where, you know, the industry wanted it to be, you know, so that was the contract that worked for the industry for the cash market and so that was the one that survived. So sometimes you know, you get your research right and it works, and sometimes you do your research and you get it wrong and that was one of those cases. And so the Board of Trade didn't win that one and the guys at NYMEX were desperate for something to trade because they, you know, they had the potato contract or something like that, you know, had fizzled out and I don't know if they had platinum yet, but they were, they were desperate for something to trade, and so they, they got it, right.

David Greely (30:31):
Well, and I also wanted to, you know, shifting gears, discuss with you the role of technology in the development of the exchanges and some of the innovations we have seen. How did computers and information technology find its way into those trading pits and eventually replace them?

John Lothian (30m 48s):
Well, when the exchanges first started, they used blackboards to report prices, and then they got, then they got electronic boards and that was a, that was a big a big change and when I came into the industry, I was working for a company called Commodity News Service and they used to put out prices and news on a thermal printer and then they had a little dumb terminal that, you know, had prices and there used to be televisions that the Board of Trade had that was a kind of in-house system and you'd go down to the bar, the sign of the trader at the, at the Board of Trade, and there would be some of these terminals that would be right in the, in the bar where guys had them put so that they could sit at the bar and trade.

John Lothian (31m 37s):
So that was the earliest use of technology. But in the late 1980s, we had a drought market in 1988, and the markets were just flying and there was a guy that had been hired by RJ O'Brien, he had been at the Chicago Sun Times, but he was brought over to be the CFO of RJ O'Brien, a longtime friend of, of Johnny O'Brien, who was the CEO and there was a day after Memorial Day where it was just crazy and markets were limit up. It was all hands on deck. So he actually went down to the trading floor, it was the only day ever working on the trading floor and he went down there and he was appalled because of, you know, the antiquated system and he's like, how are we gonna grow this business when there's no room for more brokers?

John Lothian (32m 34s):
There is no room for more runners, there's no room for more phone clerks and so he actually said, we need to bring some electronics into this and he actually had been involved in an early effort over at the Sun Times to build something that was a precursor of the internet and so he started with some technology to call back fills to route some orders down to the trading floor and that forced the CME and the Board of Trade to start an order routing technology initiative called tops stood for Trade Order Processing System and both of them started a, a project and then they decided to combine the efforts and, and work on one together and they, which they did, and they were partners in this and what it did was allow you to type an order into a dumb terminal that would then send an order down to a trading floor to a, a dot matrix printer where an order would print up, and then the order would be run into the trading pit.

John Lothian (33m 41s):
And then later the exchanges built terminals that the CME, they had the Cubs Terminal Cargo Universal Broker System. And at this board of trade, they had the electronic clerk and the, in that case, the orders transmitted directly to those systems were right at the broker and the, or the broker's assistant where, where the orders would be given to the broker and executed and then, and then typed the, the fills would be typed in and sent right back and so those were the, the, the first efforts to electronify the market. And then they, they also had some other systems that they developed. There was a system called Comet, which they had at the booths, which would allow people to basically flash in orders directly into the el electronic clerk very quickly but the Board of Trade and the C M e, the, the big markets, the financial markets, they used hand signals for a lot of the lot of the stuff.

John Lothian (34m 50s):
And so, you know, you'd see clerks on the outside of these pits receiving the stuff and flashing prices back and fills back and, and all this kind of stuff. But then you'd see people on, on headsets, you know, and all of a sudden you had clerks and brokers on headsets and, and now you had something completely different going on and ultimately, all of these things that they did to enhance the trading floor were what I called a path to electronic trading. And so I created a video series called The Path to Electronic Trading, where I interview a lot of different people about all the different things that we have done and all the different people that have contributed to the movement from open outcry trading to electronic trading and, and electronic trading and beyond, all the way up to and, and including crypto. But yeah, the electronic trading eventually became a reality.

John Lothian (35:48):
The first efforts were with that were the CME, they announced a deal with Reuters for what they called the, the Globex Alliance and what they wanted to do was sign up all these different exchanges to trade on one system, and they included in that the Board of Trade, but the Board of Trade had their own system that they were developing that was called Aurora and Aurora was really innovative. It was actually an Apple based system that had little icons in it that represented the brokers and traders and had their best price and, and quantity on it and so you could actually click on a trader and accept their offer or bid and match up the trades and everything. The problem with that system was that the, the data from that was so much that the systems at the time wouldn't, wouldn't facilitate it the network systems.

John Lothian (36m 54s):
And so ultimately they decided not to deploy that system, and then they dragged their feet on the Globex system so much and part of it was that Globex didn't do some things that the port of trade needed. The Globex system traded in decimals, the border of trade had contracts that traded in fractions and so that didn't work and so the Board of Trade developed their own system, which was a system that was a local area network and so it was just in the border of trade building in a few other buildings and so people had dumb terminals and, and could trade through that. So if you, if you were in New York and you wanted to trade electronically, you had to call somebody in Chicago and have them enter an order for you and all that kind of stuff. So it wasn't like the Reuters system, but the Reuters system was pretty slow and eventually the CME did a deal with Matif in Paris for their system, and they traded their back office clearing 21 software for the match engine and that Matif had and so they turned that into Globex too and built that out, and that became what they use today largely, or a version of that.

David Greely (38m 12s):
I wanted to ask you, John, along with the movement to electronic trading and eventually the closing of the trading pits, what do you see looking back as the big developments of recent decades?

John Lothian (38m 25s):
I mean, electronic trading, you know, not only did it kill the trading pits, but it opened up the markets for a lot of different people to participate in them. So it used to be that the trading firms or groups or whatever would hire big guys like me, you know, they played football or basketball or whatever, type A personalities. Now all of a sudden you have firms that are hiring data scientists, physicists, computer scientists, nerds essentially and so there's a lot different people that are getting into the trading world than we had before and so the expansion of that, the biggest thing to me is the expansion globally of the markets. You know, as I mentioned, the board of trade was more than 50% of the world's futures volume when, I got into the industry, and its volume went up every year.

John Lothian (39m 23s):
But the other side of that statistic was that their percentage of futures volume went down every year and ultimately the board of trade portion of the CME group volume is a, just a small part of, of the world's futures volume and so when you look at the growth of futures trading globally, that is the big thing. The volumes coming out of Asia are just tremendous these days. The ability to manage risk all over the world with contracts that are specifically designed for those types of risk. Back in the 1970s when we had inflation running rampant, people were using soybeans in order to manage their inflation risk. They were trading pork bellies or gold to manage their risk. Now they have, you know, not no longer Euro dollars, but sulfur contracts to be able to do that, or treasury complex features to be able to do that, or booned and all the contracts at URS to be able to do that, all the different exchanges around the world offering interest rate, stock index futures, and individual commodity contracts.

John Lothian (40m 42s):
So that to me is the, is the big story, is the, the worldwide expansion of it and the, the number of people that globally that have been brought into the markets. You know, you can look at algorithmic trading as a big trend. You can look at co-location as a big trend where, you know, people have their computers right next to the exchange as opposed to, you know, sitting right next to them and all that. Those certainly are big things, but you know, there's, there's more opportunity in the markets today than there, than there ever was in, in some ways, because they're accessible, they're liquid, and you know, anybody can participate and that wasn't always true. I used to tell people not to trade New York markets because you couldn't get a fill out of there and when you got a fill, it wasn't gonna be a very good one and at all and today you can get an instantaneous fill in a market, and so you know exactly where you are. You can cancel your order as many times as you want, and, you know, do things that back in the day would drive brokers crazy, drive people crazy. But today you can, you can do lots of things that, to trade any way that you want. And it's, and it gives you a lot of freedom. So I think the expansion of the markets globally and the opportunities that that presents is the biggest thing.

David Greely (42m 13s):
Yep and as we wrap things up, I was hoping you could help us put all this together and put it into perspective of the future markets today versus yesterday. I think you've given us a great sense of the biggest differences with increasing globalization, the increasing span of assets being traded, the increase in opportunity relative to what it was decades ago. I'm curious though, for you, what's always remained and what needs to remain central for these markets to be viable?

John Lothian (42m 44s):
Well, the markets need to be fair. They need to have integrity and that's at the exchange level, that's at the regulatory level, that's with the brokerage firms, the way that they deal with customers and, you know, we're pretty lucky today we've got some really good regulators in the NFA and the CFTC and the exchanges do a good job of regulating their markets. There are always gonna be people that try to abuse the markets. That's never gonna. You know, that's just part of life. So you always have to be on the lookout for it but markets, one of the things about markets is that they're supposed to be self-regulatory. So when you see something wrong, you should report it. That's the way it was in the, in the trading pit. When you saw something wrong, you dealt with it.

John Lothian (43m 41s):
Whether you dealt with it personally by not trading with a person anymore, or you dealt with it by going to the pit committee or the board of directors or, or whatever. But you dealt with it and so the integrity of the markets is really important, but we all have responsibilities for that and so I think that if the markets can, can keep their integrity, that we'll all, all do well, but, you know, the markets are really, really important to us. They play an important role for price discovery, for price discovery of key elements. When you think about the things that they help us, they help us with interest rates, they help us with energy, they help us with food, they help us with clothing, they help us with shelter, right and so they've helped us close the gap and reduce.

John Lothian (44m 53s):
And reduce the, the friction on all of those markets. So if you look back at for example, the interest rate market, when the 30 year bond market began to trade, it was essentially about a thousand dollars, a full point between the bids and offers of the cash market. When the treasury bond future started trading, it was a 32^{nd} so that $1,000 was narrowed down to $31.25 cents okay. Many of these markets have been narrowed down even more and if you look at even some of the proposals with, in front of the SEC these days, they're talking about narrowing some of the prices to less than a penny to be able to trade some of these things. So, you know, lots of bids offers have been and narrowed, and the markets are very efficient, and that helps all of us.

David Greely (45m 41s):
Well, and I really want to thank you, John, for sharing your unique perspective on the history of these markets, particularly in Chicago with us and maybe if I can push my luck, I'll ask you one more question before we go, and that is, given your understanding of history and your experience, are there ways in which you see these markets needing to change for the future?

John Lothian (46m 06s):
Well, the markets are always changing for the future. They are doing it right before our eyes and so there's new markets being developed, like the crypto markets, like the Defi markets, like you know, all of all of those kinds of things, the tokenization of things and so there is always innovation going on. There is constant movement, new exchanges being started, new contracts being started, new competition, new types of algorithms for exchange matching, all kinds of different ways of that people are trying to compete in these markets because of the great opportunity and the great liquidity for it you know, the US equity options markets are going from, you

know, 16 exchanges, up to 20 exchanges here in the near term because, you know, volume has exploded in the last couple years from 17 million contracts a day up to 40 million contracts a day.

John Lothian (47m 14s):
And some of that is through innovation of the way that exchanges are competing and some of that is just, hey, I want in on this, and we're gonna, we, we need the capacity. So I see that one of the concerns that I do have is always concentration. We do have some major players in the market where there is some concentration, and you wonder whether there is the ability for some startups to be able to, to compete, but there are places for them to compete and ways for them to be able to do that and they are always finding a way to, to be able to do that. So I'm optimistic about competition. I'm optimistic about innovation, and, you know, it sometimes innovation can be a little ugly and it takes a little while to get it right, but ultimately, I think we end up in a better place. And so I'm a believer in the process, but I do think that innovation is happening right before our eyes and you can't stop it.

David Greely (48m 27s):
Thanks again to John Lothian, Founder and Publisher of John Lothian News. We hope you enjoyed the episode. Join us next week with our two guests from CBOE, Dave Howson and Jos Schmitt. We'll be discussing the history of and lessons from the Chicago Board Options Exchange as it celebrates its 50th anniversary. We hope you'll join us.

Announcer (48m 48s):
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Announcer (49m 37s):
That concludes this week's episode of SmarterMarkets by Abaxx. For episode transcripts and additional episode information, including research, editorial, and video content, please visit smartermarkets.media. Please help more people discover the podcast by leaving a review on Apple Podcast, Spotify, YouTube, or your favorite podcast platform. SmarterMarkets is presented for informational and entertainment purposes only. The information presented on SmarterMarkets should not be construed as investment advice. Always consult a licensed investment professional before making investment decisions. The views and opinions expressed on SmarterMarkets are those of the participants and do not necessarily reflect those of the show's hosts or producer. SmarterMarkets, its hosts, guests, employees, and producer, Abaxx Technologies, shall not be held liable for losses resulting from investment decisions based on informational viewpoints presented on SmarterMarkets. Thank you for listening, and please join us again next week.