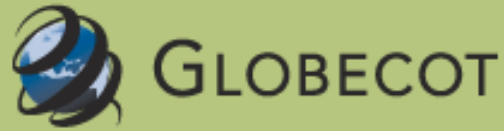


**U.S. Department of Agriculture**  
**Agricultural Outlook Forum 2005**  
**February 25, 2005**

**ZHENGZHOU COTTON FUTURES: A CHINESE SUCCESS STORY**

**Ed Jernigan, CEO**  
**Globecot, Inc.**



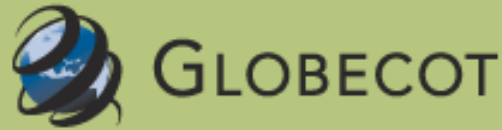
# ZHENGZHOU Cotton Futures: A Chinese Success Story

Presented by:  
Ed Jernigan, CEO  
Globecot, Inc.



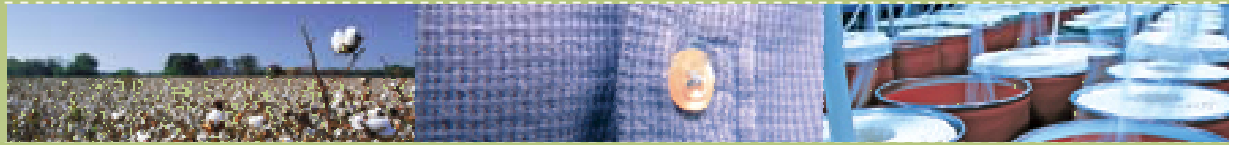
# **China & Futures: A Natural Interest**

**The first futures trading began in  
Asia -- Rice in Japan**



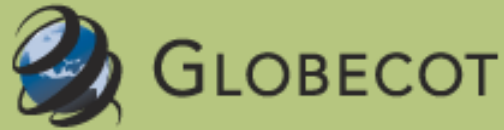
# China & Futures: The Beginning

- October 1990: first grain wholesale spot market opens
- September 1991: aluminum futures begin trading on Shenzhen
- 1992: first futures brokerage firm opens
- 1993: Zhengzhou commodity exchange transfers business to futures
- 1994: government approves 11 futures contracts on a trial basis



# China & Futures: The Beginning

- April 1994: government bans futures in steel, sugar, coal
- September 1994: government bans futures in rice and rapeseed
- 1998: 14 futures exchanges consolidated into 3:
  - Shanghai Futures Exchange
  - Zhengzhou Commodity Exchange
  - Dalian Commodity Exchange



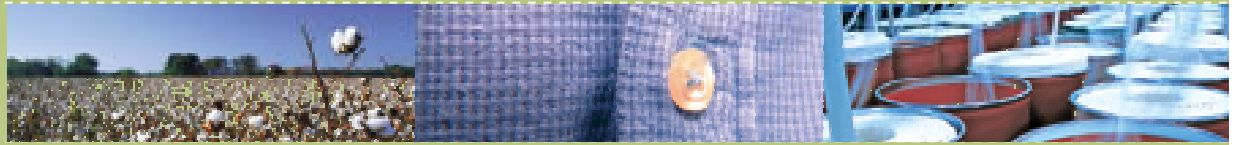
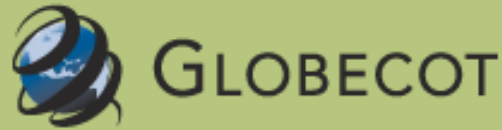
# China & Futures: The Beginning

- Today's futures trade occurs on those 3 exchanges
- June 1, 2004: Cotton Futures opened on Zhengzhou commodity exchange



# Zhengzhou Commodity Exchange: Background

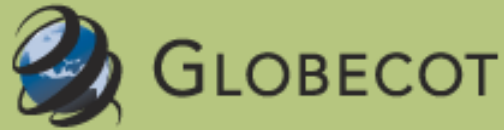
- Established 1990, evolved from Zhengzhou grain wholesale market.
- 1993: Launched futures: wheat, corn, soybeans, green beans, sesame
- 1993-1999: green beans most active contract.
- 1999: wheat took over top position.



# Zhengzhou Commodity Exchange: Background

- 2003: 2<sup>nd</sup> wheat contract added
- 2000: Computer trading introduced
- 2003: daily volume in wheat futures reached a record 887,446 contracts
- 2003: open interest in wheat reached 716,316 contracts





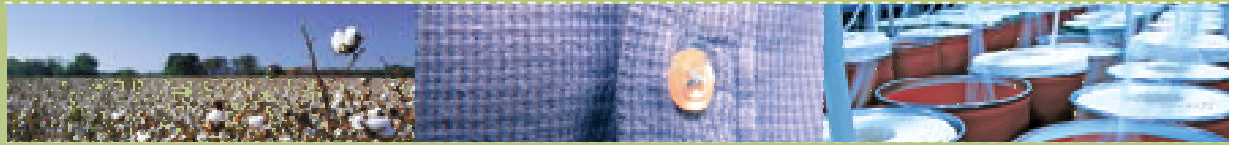
# Zhengzhou Commodity Exchange: Today

- Non-profit organization
- 218 member firms
- Electronic trading



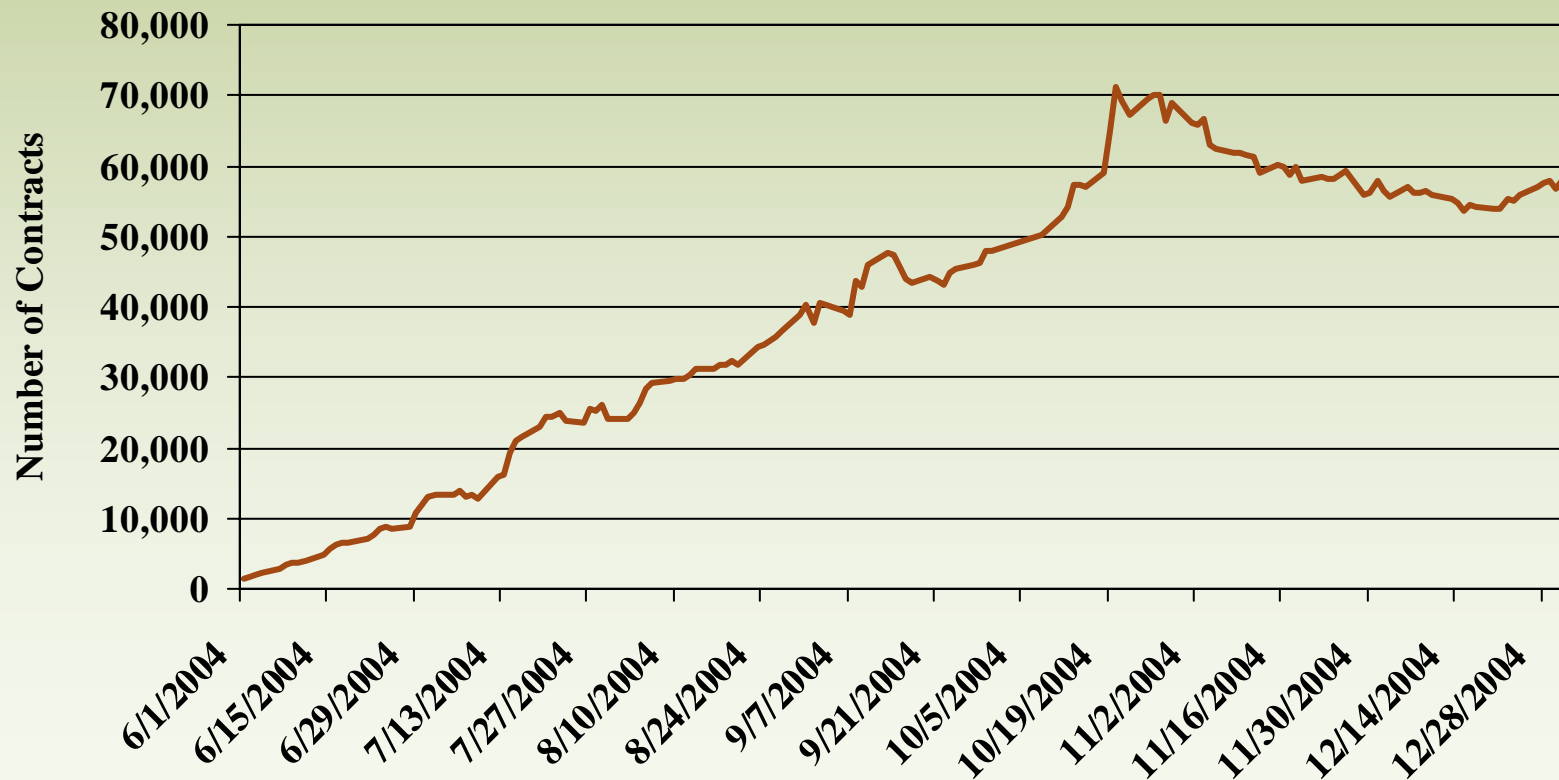
## ZCE: Cotton Futures – A Success from Opening Day

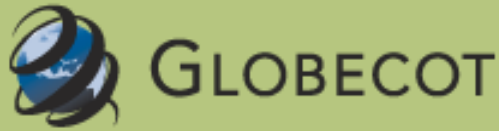
- Most successful new cotton futures contract ever introduced.
- Enjoyed liquidity from opening day.
- By November 1, open interest reached over 70,000 contracts.
- Daily volume averages over 50,000 contracts.



# ZCE Open Interest

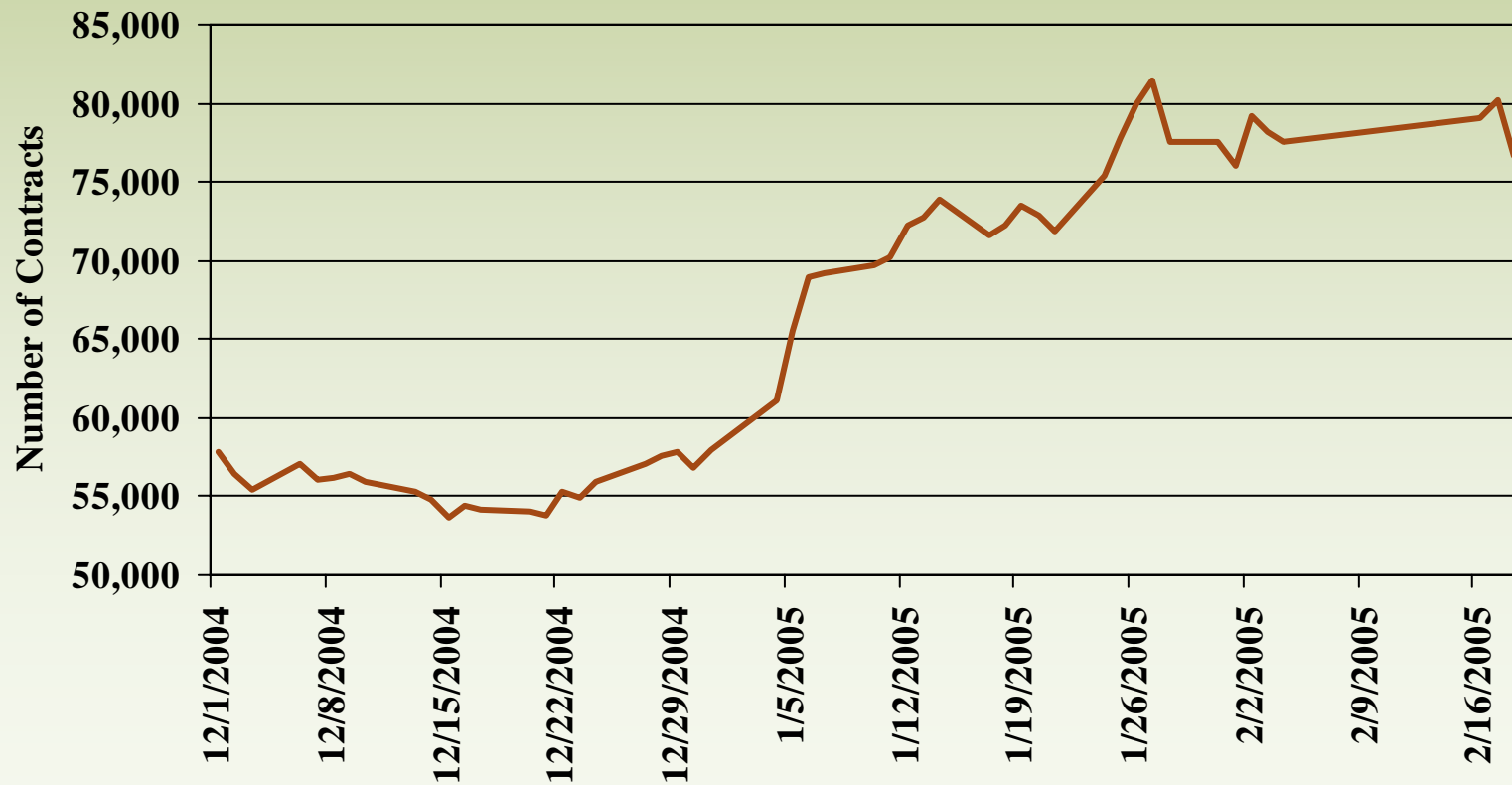
## June 1, 2004 – December 31, 2004

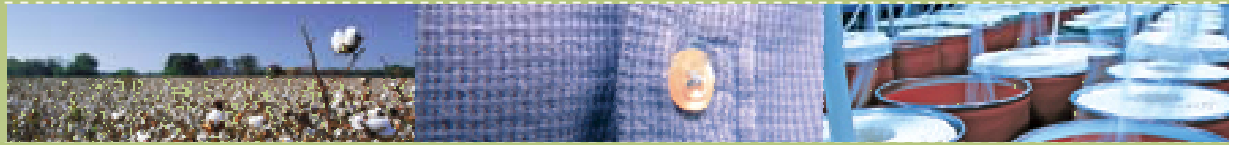




# ZCE Open Interest

## December 1, 2004 – February 18, 2005





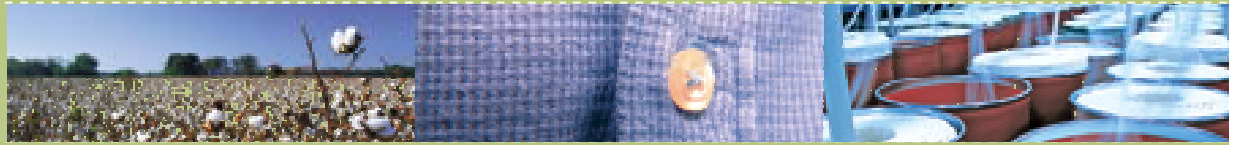
# ZCE Cotton Futures: What's Behind the Success

- Base quality mirrors domestic cotton use and production.
- Strong physical delivery mechanism.
- Active movement in underlying cash commodity.
- Strong regulatory procedure.
- Widespread familiarity of futures and their use.



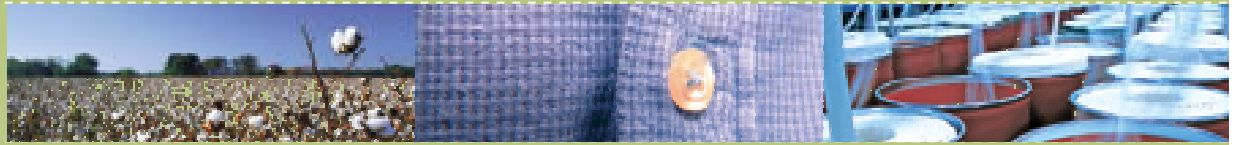
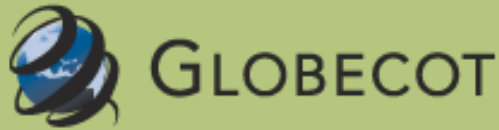
# ZCE Cotton Futures: What's Behind the Success

- Base quality mirrors domestic cotton use and production:
  - Over 80-percent of all Chinese cotton produced is M 1-3/32” or better quality
  - Over 75-percent of all domestic cotton consumption is M 1-3/32” or better quality



## ZCE Cotton Futures: What's Behind the Success

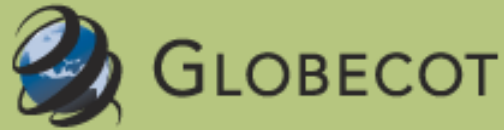
- Base quality: T328, equivalent to U.S. Grade M 1-3/32.”
- Other features: deliverable quality range, mike 3.5 to 4.9.
- Quality T129 to T429 tenderable, with premium and discount.



# ZCE Cotton Futures: What's Behind the Success

- Strong physical delivery mechanism:
  - All cotton is re-graded by FIB when placed in a certified warehouse.
  - All cotton is again classed by FIB when delivery takes place.
- Created strong integrity in the quality of cotton received by buyer, no dumping by seller.
- ZCE futures trade at a premium to general physical prices for that reason.



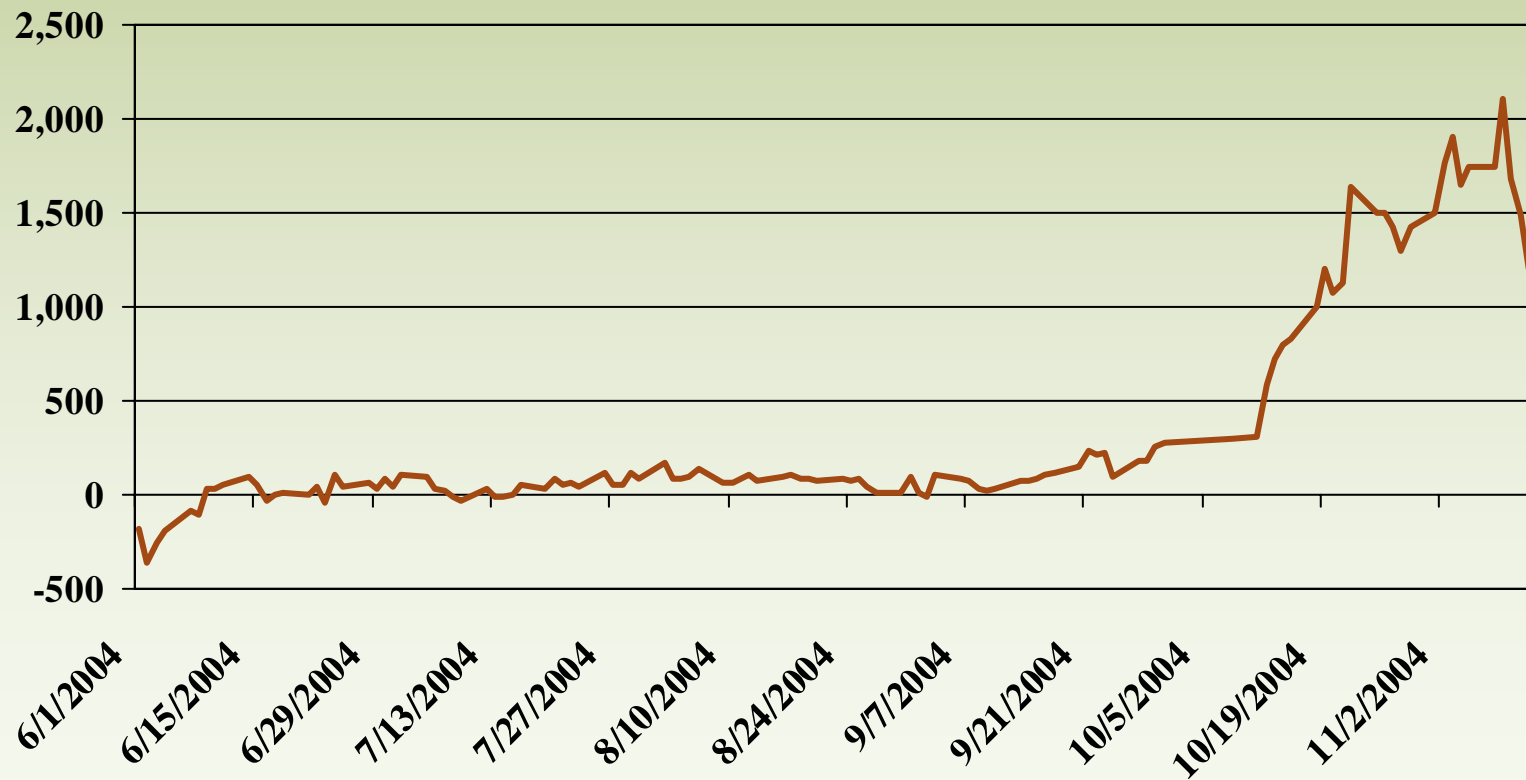


# ZCE Cotton Futures: What's Behind the Success

- Strong physical delivery mechanism
  - All delivery in 20 ton lots.
  - 13 approved delivery warehouses in East China.

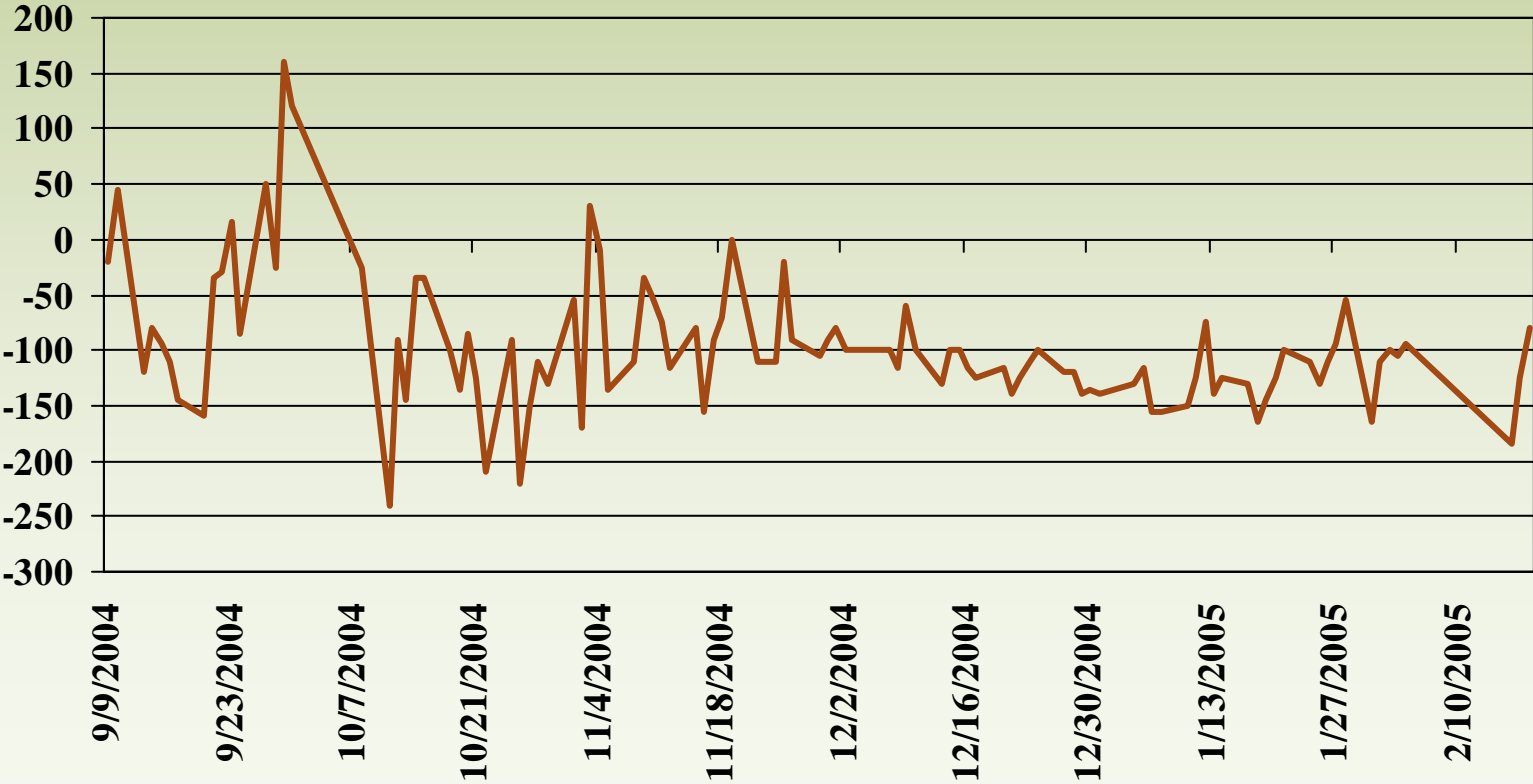


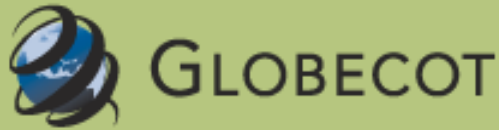
# ZCE Cotton Futures November/December 2004 Spread





# ZCE Cotton Futures March/April 2005 Spread





# ZCE Cotton Futures: What's Behind the Success

- Active movement in underlying cash commodity.
- China physical price movement is now a free market:
  - Significant volatility.
  - Prices less influenced by government than in the United States.



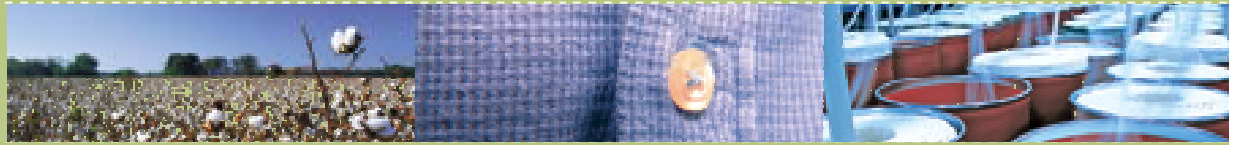
# ZCE Cotton Futures: What's Behind the Success

- Strong regulation procedure:
  - Delivery integrity.
  - Position limits.
  - Daily price limits.
  - Strict margin rules.

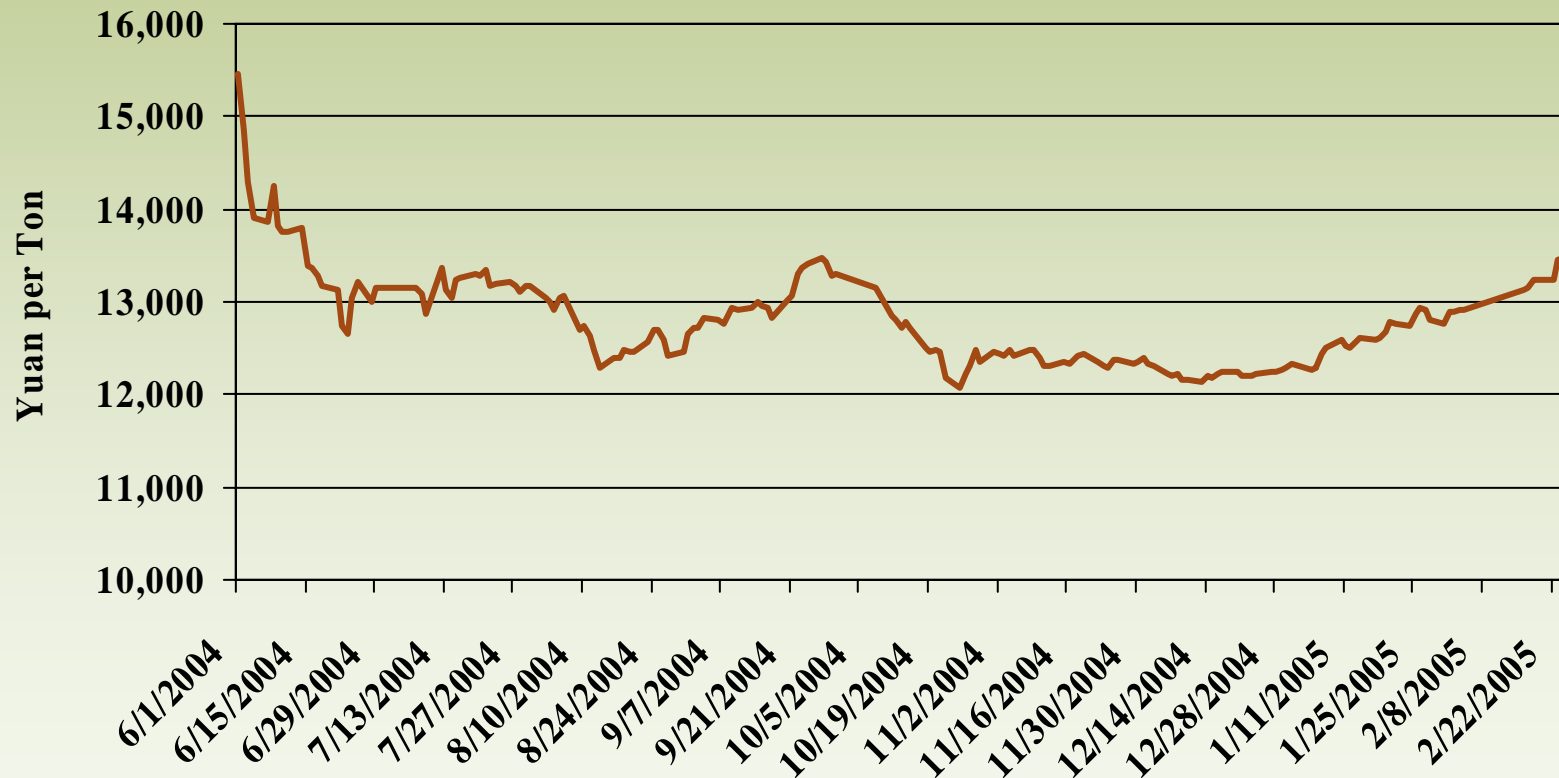


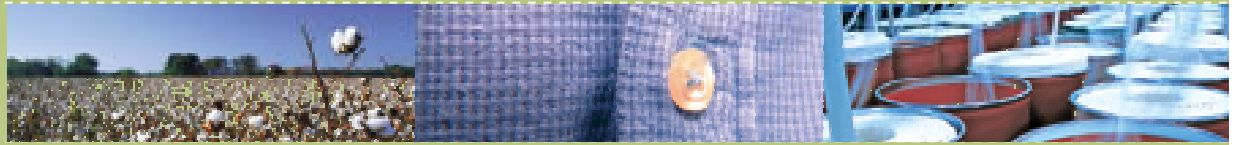
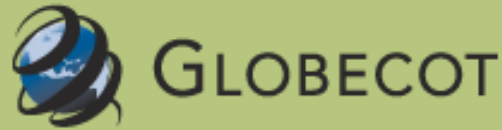
# ZCE Cotton Futures: What's Behind the Success

- Widespread familiarity of futures and their uses.
  - Domestic futures volume has soared since introduced.
  - Volume in many of the grain contracts exceeds CBOT.
  - Poor performance of domestic equity and bond market make futures attractive alternative.



# ZCE March 2005 Contract





# Today: ZCE Cotton Futures Are A Big Success

- Daily volume average two to three times that of NYBOT.
- Reflects domestic cotton price movement in China.
- Open interest is averaging above NYBOT after less than one year.