### Definition of Commodity Exchanges:

A commodity exchange is an organised mar­ket that functions under established rules and regulations. This market is the place for the pur­chase and sale of commodities.

**J. F. Pyle has de­fined organised market in this way:**

Commodity exchanges are specialised organised markets which provide a place where their members buy and sell commodities or contract for future delivery under established rules and regulations.

Commodity Market?

A commodity market is a physical or virtual marketplace for buying, selling, and trading raw or primary products. There are currently about 50 major commodity markets worldwide that facilitate trade in approximately 100 primary commodities.

Commodities are split into two types: hard and soft commodities. Hard commodities are typically natural resources that must be mined or extracted—such as gold, rubber, and oil, whereas [soft commodities](https://www.investopedia.com/terms/s/softcommodity.asp) are agricultural products or livestock—such as corn, wheat, coffee, sugar, soybeans, and pork.

**The commodities which are generally traded in at the commodity exchanges include the follow­ing:**

(i) Natural produce of the soil e.g. cotton, wheat, tea, jute etc.

(ii) Mineral products like copper, gold, mica, lead etc.

(iii) Some manufactured products like gunny bags, clothing, hides, artificial jams etc.

All types of commodities are not fit for deal­ings in the commodity exchanges.

**The products which possess the following characteristics are fit for dealing in commodity exchange:**

#### 1. Homogeneity:

The commodity must be ho­mogeneous i.e., all units of a particular commodity must be perfectly identical so that all dealers may mean the same commodity when they men­tion it in their dealings.

#### 2. Durability:

It must be durable so as to last for a period of a future contract (ordinarily more than one year). If it perishes rather quickly, con­tracts for its purchase and sale will be frustrated.

#### 3. Gradability:

The commodity should be such as will lend itself to grading. If the commod­ity cannot be classified into well-known grades, trading will be difficult for every time the quality will have to be ascertained.

#### 4. Price Fluctuation:

There must be frequent fluctuations in the price of the commodity. If there were no price fluctuations, the speculators would have no intention to speculate in it at the exchange.

#### 5. Open Supply:

The supply of the commod­ity should be open and free and should not be monopolized by one or a few persons. Again, the sup­ply of the commodity or its price must not be controlled by the Govt.

### Objectives of Commodity Exchanges:

The organised market represents a public or­ganisation consisting of buyers, sellers, producers, traders and dealers dealing in one or more com­modities which constitute the articles of trade in the market. The exchange for commodity is a private as­sociation of dealers and is not for making money or profit or for fixing prices.

Its objectives are to provide an open platform for the interaction of free play of the forces of demand and supply. It only registers the prices reflecting the forces of de­mand and supply. Buying and selling, trading practices and ac­tual working of the organised market are governed by a code of rules and regulations and these can ensure fair dealings, fair prices and equity.

### Nature of Commodity Exchanges:

**Organised market has the following features:**

1. Best facilities available for close and continuous contact between total demand and total supply both present and potential.

2. All businesses are governed by rules and regulations and these rules are strictly enforced by the exchange authorities.

3. Usually the exchange enjoys internal au­tonomy and it is self-regulated, self-administered and self-disciplined autonomous body. At present, almost in all organised markets there are special legislations to control the activities of these organ­ised markets.

4. There is free competition of buyers and sell­ers. The forward markets for commodities and se­curities are also known as two-way auction mar­kets. Open public outcry gives offers and bids by sellers and buyers. They also use finger signals to declare their prices and amounts.

5. Every forward market has a clearing house organisation to facilitate clearing of all dealings and their settlement. The clearing house guarantees payment of dues and taking and giving of delivery of commodities or securities during the settlement period.

6. An organised market acts as a clearing house of market information, i.e., collection of all facts and figures and regular publicity of all relevant sta­tistical information which helps the traders to esti­mate and forecast price trends, changes in demand and supply. Constant price quotation services en­able people to make their purchases and sales with certainty and confidence.

7. The speculative trader is a necessary and vi­tal part of any broad and stable commodity or se­curities market. Speculation is an integral part of market mechanism whether in stock exchange or in commodity exchange.

8. It is a convenient central market place.

### Functions of Commodity Exchanges:

Commodity exchanges are generally utilised for wholesale dealings in agricultural commodities or the products of some important primary indus­tries like lumbering.

**These exchanges perform the following important functions:**

#### 1. Providing a Market Place:

A commodity exchange provides a convenient place where the members can meet at fixed hours and transact busi­ness in a commodity according to a certain well established rules and regulations. This type of facility is very important for trading in such com­modities as are produced in abundance and cover a very wide field as far as trading therein is con­cerned.

#### 2. Regulating Trading:

As organised markets commodity exchanges establish and enforce rules and regulations with a view to facilitating trade on sound lines. The rules define the duties of mem­bers and lay down methods for business transac­tion.

#### 3. Collecting and Disseminating Market In­formation:

The buyers and sellers on the commod­ity exchange enter into deals for settlement in fu­ture after making an assessment the trends of price and the prospects of a rise or fall in prices of a com­modity. The commodity exchange acts as an asso­ciation of these traders collecting the necessary in­formation and the relevant statistical data and pub­lishing it for the benefit of traders all over the country.

#### 4. Grading of Commodities:

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Commodities which are traded on the commodity exchanges have, to be graded according to quality. In this manner, the dealers can quickly enter into agree­ments for the purchase and sale of commodities by description.

#### 5. Settling Disputes through Arbitration:

The commodity exchange provides machinery for the arbitration of trade disputes.

### Services of Commodity Exchanges:

While performing these functions the com­modity exchanges render a variety of valuable serv­ices to the producers, consumers, traders and oth­ers in the community.

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**The most important of such services are as follows:**

1. The exchanges provide a ready and continu­ous market for the purchase and sale of commodi­ties. The producer is enabled to be independent of the middlemen.

2. By providing hedging facilities, the com­modity exchanges reduce the effect of fluctuations in price.

3. The commodity exchanges provide the pro­ducers an opportunity to transfer their risk to the professional risk-bearers.

4. By providing continuity in the trading of commodities, the commodity exchanges induce bankers and financiers to lend against commodi­ties.

5. The commodity exchanges provide facilities and opportunities for arbitrating and thus equalize the price levels of commodities at various centres.

## Major Commodity Exchanges in India:

* Multi Commodity Exchange of India
* National Commodity and Derivatives Exchange
* Indian Commodity Exchange
* National Multi Commodity Exchange of India

Trading on all the commodity exchanges In India was regulated by Forward Markets Commission (FMC) till 2015, when it was merged with Securities Exchange Board of India (SEBI). Since the merger, it is the securities market regulator SEBI that regulates commodities trading in the country.

# Commodity Market Participants : Hedgers, Speculators and Arbitrageurs

The commodity market needs many participants with different investment objectives and risk profiles. This allows the market to function effectively. The participants play different roles in the market by using the commodity futures contract.

Hedgers :

Hedgers are commercial producers or consumers of a traded commodity. Examples are copper smelters, oil companies, farmers, and jewellers. Hedgers are exposed to commodity price volatility in the spot market. They use the futures market to offset (hedge) this risk. Suppose gold prices are unstable. A jeweller would want to offset a possible risk of loss on his monthly gold purchases due to this volatility. If he expects the price to rise next month, he could go long on (buy) a gold futures contract with a one-month expiry period. The contract will let him buy gold at the current price even if the prices rise in a month. But, if the prices fall during this time, he will not profit from it. That is because he still has to buy gold at the price specified in his futures contract.

Speculators :

Speculators may not have any exposure to the spot market. To them, commodity futures are an investment avenue, like the stock market. They try to make money by speculating on commodity prices, just as they would by speculating on stock prices. As such, speculators never receive delivery of the physical commodity. They take a position in commodity futures and square it off before expiry. This means, they settle by buying or selling a contract that is exactly the opposite of the contract they currently hold. This only involves payment in cash and no delivery of the underlying commodities.

Arbitrageurs :

Arbitrageurs try to profit from the difference in the prices of the same commodity in two different markets. They take a long position (buy) in the market where the price is lower and a short position (sell) in the market where it is higher. The difference between the two prices is their profit. Arbitrage transactions are usually risk-free. Constant arbitrage reduces the price in the market where it is higher and increases it in the market where it is lower. Arbitrage stops when prices become similar in both markets.

Their varying preference for risk and return distinguishes market participants from each other. The different categories of participants respond differently to a market development because of their differing risk-return preferences. These differing responses determine how the market price of a commodity will move.

Commodities traded in commodity exchanges

Many commodities trade on commodity exchanges around the world. These commodities can be classified based on their use and consumption or their characteristics.

One way of categorising commodities is into four groups: foodstuff, industrial metals, precious metals, and energy. Some commodities that fall under each of these groups are given below.

* **Foodstuff**
* Coffee
* Sugar
* Cocoa
* Maize
* Rough rice
* Soybean
* Wheat
* Sunflower Oil
* Barley
* Orange Juice
* **Industrial Metals**
* Copper
* Lead
* Zinc
* Tin
* Aluminium
* Nickel
* Recycled
* **Precious Metal**
* Gold
* Platinum
* Palladium
* Silver
* **Energy**
* Crude Oil
* Natural Gas

# How to Trade in Commodities Market

You are now familiar with the basics of commodity trading in India. In this section, you will learn how to trade in commodities using the knowledge gained so far.

Commodity trading in India is much easier now than it used to be. Nation-wide multi-commodity exchanges, such as NCDEX and MCX, provide investors an easy, safe, and hassle-free platform for commodity trading. These exchanges have electronic settlement systems that allow you to trade at just the click of a button, from any location. You do not even need to possess the commodity physically. You can simply make a trade and pocket the profit upon squaring it off, without the commodity changing hands. Thanks to electronic trading, physical delivery of the commodity happens for less than 1% of the total trade volume.

Trading in commodities involves three simple steps, regardless of which exchange you are trading on. These steps are:



# Glossary of Commodity Market Terms (A-C)

Who would not want a handy guide containing all the jargons from the commodity trading world! Well, you’re in for luck. Here is a glossary of all terms, categorised in alphabetical order.

There are two parts to the commodity trading process: order processing and mark to market (MTM) settlement.

Arbitrage : The simultaneous purchase and sale of similar commodities in different markets. Sometimes the same commodity trades at different prices in different markets. A profit can be made by buying at a low price in one market and selling at a high price in another.

Arbitration : The procedure of settling disputes between brokers, or between brokers and their customers. The process is overseen by a financial regulatory authority.

Bar Chart : A bar chart used in technical analysis and is represented by a vertical line. The top of the vertical line indicates the highest price a commodity is traded at during the day. The bottom represents the lowest price. The closing price is displayed on the right side of the bar. And the opening price is shown on the left.

Basis : The difference between the current cash price and the futures price of the same commodity. Unless otherwise specified, the price of the nearby futures contract month is generally used to calculate the basis.

Bear : A bear is an investor who believes that the price of a particular commodity is headed downward. The investor wants to sell the commodity at current prices to limit losses.

Bear Market : A market condition in which the prices of commodities are falling. Investors anticipate losses in a bear market and continue to sell. This further fuels pessimism in the market.

Bid : A bid is an offer made by an investor, trader, or dealer to buy a commodity. It specifies the price and quantity of a commodity a buyer is willing to buy.

Broker : A company or individual that executes futures and options orders on behalf of investors.

Brokerage Fee : A fee charged by a broker for executing a transaction between a buyer and seller. It is charged for services such as purchases, sales, and advice on the transaction, negotiations or delivery. It is also referred to as commission fee.

Bull : An investor who thinks market prices will rise. Investors who take this approach buy commodities in order to sell them at higher prices later.

Bull Market : It is a market condition in which prices of commodities are rising.

Carrying Charge : Storing physical commodities such as grains and metals involves certain costs. These include the cost of storage space, insurance, interest etc. Together they are known as 'carrying charge'. It is also referred to as the cost of carry or carry.

Cash Commodity : An actual physical commodity someone is buying or selling. For example soybeans, palm oil, gold, silver, etc. It is also referred to as actuals.

Cash Market : A place where people buy and sell the actual physical commodities. It is also called spot market.

Charting : The use of charts to analyze market behaviour and anticipate future price movements. In this method, investors can plot factors such as settlement prices, average price movements, volume, and open interest on charts. Two basic price charts are bar charts and point-and-figure charts.

Clearing Corporation :

Order : An independent corporation that settles all trades made at an exchange. It acts as a guarantor for all trades cleared by it. It ensures each day that all gains have been credited and all losses have been collected. It also sets and adjusts clearing member firm margins for changing market conditions.

Clearing House : It is an agency or separate corporation of a futures exchange. It is responsible for settling trading accounts, clearing trades, collecting and maintaining margin monies, regulating delivery, and reporting trading data. Clearing houses act as third parties to all futures and options contracts. They act as a buyer to every clearing member seller and a seller to every clearing member buyer.

Clearing Member : A member of an exchange clearing house. They are also known as brokers. Clearing members are responsible for the financial commitments of customers that clear through their firm.

Closing Price : The closing price is the average price at which a contract trades. It is calculated at both the open and close of each trading day. It is important because it determines whether a trader is required to post additional margins. It is also known as settlement price.

Closing Range : In the futures market, it refers to the trading range during the official closing period specified by the exchange. It specifies the minimum and maximum prices that a contract traded at during close.

Commission Fee : A fee charged by a broker for executing a transaction between a buyer and seller. It is charged for services such as purchases, sales, and advice on the transaction, negotiations or delivery. It is also referred to as brokerage fee.

Commodity : An article of commerce or a product that can be used for commerce. In a narrow sense, products traded on an authorized commodity exchange. The types of commodities include agricultural products, base metals, bullion and energy products.

Convergence : It is when cash and futures prices of a commodity tend to come together as the futures contract nears expiration. It implies that the basis is approaching zero.

Cost of Carry (or Carry) : Storing physical commodities such as grains and metals involves certain costs. These include the cost of storage space, insurance, interest etc. Together they are known as the cost of carry.

Daily Trading Limit : The maximum gain or loss on a commodities futures contract that is allowed in any one trading session. The exchange sets these limits to protect investors from extreme volatility.

Deferred (Delivery) Month : The more distant month or months in which futures trading is taking place. For example, in a five-month futures contract, the months four and five are deferred months. It is the opposite of nearby (delivery) month.

Day Traders : They are speculators who take positions in futures and liquidate them on the same trading day. Their strategy is to profit from intraday movements in the price of a commodity. A day trader closes all trades before market close. He does not hold any open positions overnight.

Deliverable Grades : They specify the quality of a commodity that is to be delivered under a particular contract. For example, oil comes in many different qualities. And each grade of quality has a different price. Deliverable grades ensure that the buyer and seller agree upon the quality of a commodity. They are also referred to as contract grades.

Delivery : Delivery is the action by which a commodity is physically transferred to the buyer under a contract. Each futures exchange has specific procedures for delivery of a commodity. Delivery can occur in spot, option, or forward contracts. But many times a contract is closed out before settlement. In this case no delivery occurs.

Delivery Month : A specific month in which delivery of a commodity may take place under the terms of a futures contract. It is also referred to as contract month.

Equilibrium Price : The market price at which the quantity supplied of a commodity equals the quantity demanded.

Expiration Date : Each futures contract is active for a specific amount of time during which it can be traded. The date on which a futures contract stops trading is its expiration date. The date is fixed by the futures exchange. The expiration date represents the day when physical goods are actually delivered for cash.

Full Carrying Charge Market : It is a futures market where contracts with a later maturity have higher future prices compared to current spot prices. These prices are higher because they take into account the cost of storing a commodity.

Fundamental Analysis : A method of anticipating future price movement using supply and demand information.

Futures Contract : A legally binding agreement to buy or sell a commodity or financial instrument sometime in the future. Futures contracts are standardized according to the quality, quantity, and delivery time and location for each commodity. The only variable is price, which is determined on an exchange-trading floor.

Futures Exchange : It is a central marketplace with established rules and regulations. Here buyers and sellers meet to trade futures and options on futures contracts.

Hedger : A hedger owns or plans to own a physical commodity such as gold or soya beans. But he is concerned that the cost of the commodity may change. He, therefore, achieves protection against changing cash prices by purchasing a futures contract of the same commodity.

Hedging : Hedging is done in order to protect against the risk of price changes of a commodity in the future. A hedger owns or plans to own a physical commodity. In order to hedge, he also takes a position in the commodity in the futures market. Hedgers use the futures markets to protect their businesses from adverse price changes.

High : The highest price of the day for a particular futures contract.

Initial Margin : The amount a futures market participant must deposit into his margin account at the time he places an order to buy (sell) a futures contract.

Inverted Market : A futures market in which the more distant the contract month, the lower is the futures price.

Liquidate : Liquidate means to convert assets into cash or equivalents by selling them on the open market.

Long position : A position where the investor buys futures contracts or owns a cash commodity.

Long Hedge : Buying a futures contract to protect against a possible price increase in a commodity that will be bought in the future. It benefits a company that knows it has to buy a certain commodity in the future and wants to lock in the purchase price.

Low : The lowest price of the day for a particular futures contract.

Maintenance Margin : A set minimum margin that a customer must maintain in his margin account.

Margin Call : A call from a clearing house to a clearing member, or from a brokerage firm to a customer, to bring margin deposits up to a required minimum level.

Market Order : It is the order to buy or sell an investment immediately at the best available current price. An investor makes the order through a broker or brokerage service.

Marking-to-Market : To debit or credit on a daily basis a margin account based on the close of that day's trading session. In this way, buyers and sellers are protected against the possibility of contract default.

Nearby (Delivery) Month : The futures contract month closest to expiration. For example, in a five-month futures contract, the first and the second month are considered to be nearby months. It is the opposite of deferred (delivery) month. It is also referred to as spot month.

Offer : An offer is when one party expresses interest in selling a commodity or a contract at a given price. It is the opposite of bid.

Offset : Taking a second futures position opposite to the initial or opening position. Investors offset commodity futures contracts to avoid actually delivering physical commodities.

Open Interest : The total number of futures contracts of a commodity that have not yet been offset or fulfilled by delivery. Technical analysts use this concept to make certain predictions about the market.

Position : It is a market commitment made by the buyer or seller of a futures contract. A buyer of a futures contract is said to have a long position. Conversely, a seller of futures contracts is said to have a short position.

Price Discovery : Price discovery is the process of determining the price for a specific commodity. These prices are dependent upon market conditions affecting supply and demand.

Price Limit : Commodity exchanges set limits on the maximum price rise and fall for a contract in one trading session. These are known as price limits. This rise or fall is calculated over the previous day’s settlement price.

Settlement Close Out Price : The last price paid for a commodity on any trading day. The exchange determines a firm's net gains or losses, margin requirements, and the next day's price limits, based on each contract’s settlement price. In some cases there is a closing range of prices. Here the settlement close out price is determined by averaging those prices.

Short Position : A position where the investor sells futures contracts or plans to purchase a cash commodity.

Short Hedge : Selling futures contracts to protect against a possible fall in prices of commodities that will be sold in the future. Producers of commodities can use this method to lock in a selling price.

Speculator : A speculator is a person who assumes a high level of risk when trading in commodities or commodity futures. This high risk gives him the possibility to earn a higher-than-average profit.

Spot : Usually refers to a cash market price for a physical commodity that is available for immediate delivery.

Spread : The price difference between two related markets or commodities or between contracts of different maturities of same commodity.

Volatility : It is the rate at which the price of an asset increases or decreases over a given period of time. Volatility measures the risk of an asset.

Volume : The number of purchases or sales of a commodity futures contract made during a specified period of time. It is measured in terms of the total transactions for one trading day.