

Contents

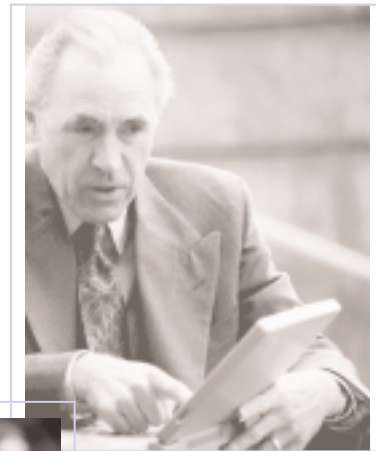
Introduction	1
Using CBOT® Dow Jones Composite Average SM Futures	2
Opportunities in Sector Indexes—Trading the Dow Jones Transportation Average SM and the Dow Jones Utility Average SM	3
CBOT® Dow Jones Transportation Average SM Futures Contract.	4
The Dow Jones Utility Average SM	6

The CBOT® Dow JonesSM Investor’s Guide introduces the basic concepts and applications you need to be aware of in order to use stock index futures and futures options. The guide offers several examples showing how you can use these exciting tools to increase or decrease your market exposure. If you are new to the futures markets, you should read the Investor’s Guide first to gain a basic understanding of how these markets work. This booklet builds upon the principles highlighted in the Investor’s Guide and introduces strategies and scenarios using other futures contracts in the CBOT® Dow JonesSM complex.

Introduction

The CBOT® Dow JonesSM complex includes the Dow Jones Industrial AverageSM, the Dow Jones Transportation AverageSM, the Dow Jones Utility AverageSM, and the Dow Jones Composite AverageSM.

The Dow Jones Composite AverageSM (DJCASM) consists of the 65 stocks included in the industrial, transportation, and utility averages and offers broad exposure to overall market activity. With this index, you can participate in market rallies by buying a CBOT® DJCASM futures contract. You can also use this contract to profit in falling markets by selling a CBOT® DJCASM futures contract.





Using CBOT® Dow Jones Composite AverageSM Futures

A variety of opinions, insights, tax issues, risk tolerances, and economic factors drive your equity investment decisions. You might have a portfolio that has performed well, but now you fear the bull market is due for some rough times. Rather than liquidating your portfolio and facing a tax event, you can use CBOT® DJCASM futures to reduce your equity exposure yet keep your portfolio intact.

Suppose the June 1 value of your portfolio is \$250,000. If your outlook suggests the market is due for a fall and you want to lock in this current value, you can take any of several actions. For one, you can sell your stocks. Among the disadvantages of that approach, you could face a significant capital gains tax from such a sale. Another possible move would be to sell your futures as a substitute for the actual stock sale.

With the September CBOT® DJCASM contract trading at 3,100, and given its \$20 multiplier, one futures contract has a value equivalent to a \$62,000 holding in the underlying index ($3,100 \times \$20 = \$62,000$). To determine how many futures contracts to sell, divide the current portfolio value by the equivalent value of the futures contract. Rounding to the nearest full contract, you can see that four futures contracts closely approximate the value of your portfolio.

$$\$250,000 \div \$62,000 = 4.03$$

Accordingly, you can sell four September CBOT® DJCASM futures contracts at 3,100.

Suppose that your fears of a market drop are realized. On July 15, the value of your portfolio has fallen to \$225,800, and the September CBOT® DJCASM futures are trading at 2,800, a 300-point drop.

At this point, if you believe the market has fallen as far as it is going to and the bull market is poised to resume, you can offset your short futures position by buying four September CBOT® DJCASM futures at 2,800.

This sequence of futures transactions results in a \$6,000 per contract gain ($300 \times \$20 = \$6,000$). Given the four-contract position, the total profit would be \$24,000.

Summarizing the trade sequence:

June 1:	sell 4 September CBOT® DJCA SM futures contracts	3,100
July 15:	buy (offset) 4 September CBOT® DJCA SM futures contracts	2,800
Resulting gain, index points:		300
Resulting gain, dollar value:		$300 \times \$20 \times 4 = \$24,000$

With this \$24,000 futures gain, the effective value of the portfolio is \$249,800 ($\$24,000 + \$225,800$). Consider that while the actual portfolio suffered a decline of almost 10%, the gain on the futures position buffered this loss and preserved the value of the original holding.

Having liquidated the futures position, you can buy additional stock at these lower levels. You would have avoided an adverse tax consequence of an actual sale of the stock. And you would have your entire portfolio in place, poised to benefit from the anticipated market upturn.

Notice that, had the market risen instead of fallen, your stock portfolio would have gained in value. However, the short futures position would have suffered a loss that would have offset any gain from the market rally.

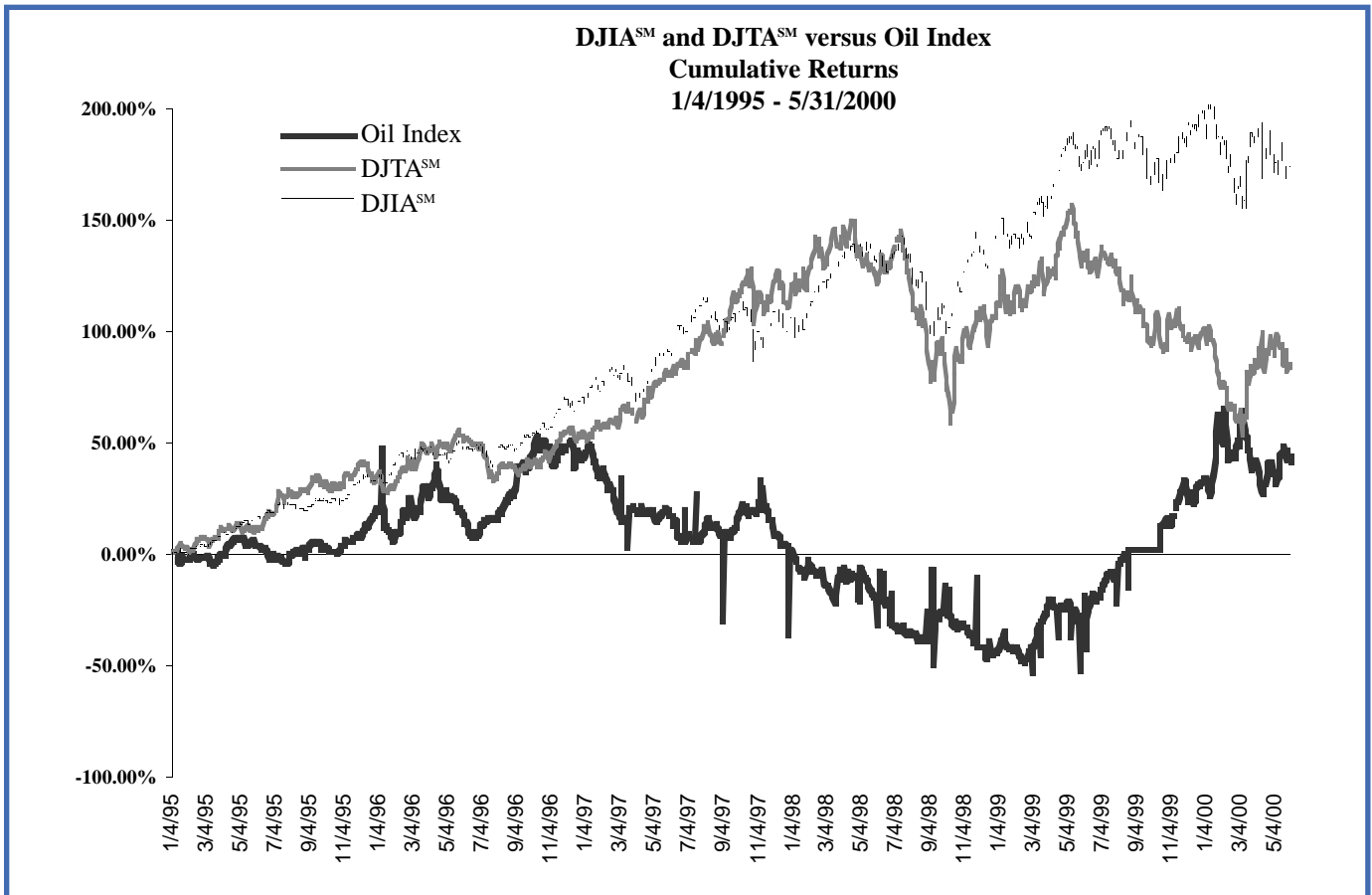
Opportunities in Sector Indexes— Trading the Dow Jones Transportation AverageSM and the Dow Jones Utility AverageSM

The Dow Jones Transportation AverageSM (DJTASM) and the Dow Jones Utility AverageSM (DJUASM) are sector indexes. Each reflects the way one economic sector responds to

economic change. In contrast, broader indexes like the Dow Jones Composite AverageSM or the Dow Jones Industrial AverageSM attempt to capture the dynamics of the stock market as a whole.

CBOT[®] Dow Jones Transportation AverageSM Futures Contract

The Dow Jones Transportation AverageSM includes the stocks of 20 transportation industry leaders—among them Southwest Airlines, Norfolk Southern, and Federal Express (see table on page 8 for a complete listing). The profitability of companies in the transportation sector depends crucially on energy prices—especially crude oil and the products distilled from it. As energy prices increase, as the chart below shows, transportation sector operating costs also increase, a factor that will typically drive profits and stock prices down for companies



in this sector. Conversely, should energy prices decline, investors can expect transportation companies to become more profitable. That should lead to higher stock prices for sector members.

It follows that, as energy outlooks change, investors might want to alter their exposures to the transportation sector. They can do this quickly, and in a cost-effective way, using CBOT® DJTASM futures.

Suppose, while studying energy market developments, you notice crude oil stocks have increased substantially and that the OPEC production agreement seems poised to fall apart because member nations are exceeding production quotas. You conclude oil prices are close to peaking and will soon head lower. It follows that transportation stocks should be poised to rally.

On September 8, expecting this transport sector rally and with December CBOT® DJTASM futures trading at 2,850, you can buy (go long) one December futures contract at 2,850. With each index point having a \$20 cash equivalent value, this one futures contract gives you control of a position with a \$57,000 cash equivalent value ($2,850 \times \$20 = \$57,000$).

Suppose that by October 25, crude oil prices have fallen dramatically, and the December CBOT® DJTASM futures contract has rallied to 3,025. If you think the crude market has bottomed, you can liquidate your futures position by selling one December CBOT® DJTASM contract. In the language of the futures market, this second transaction offsets the first.

With each DJTASM index point worth \$20, the gain on this trade is \$3,500.

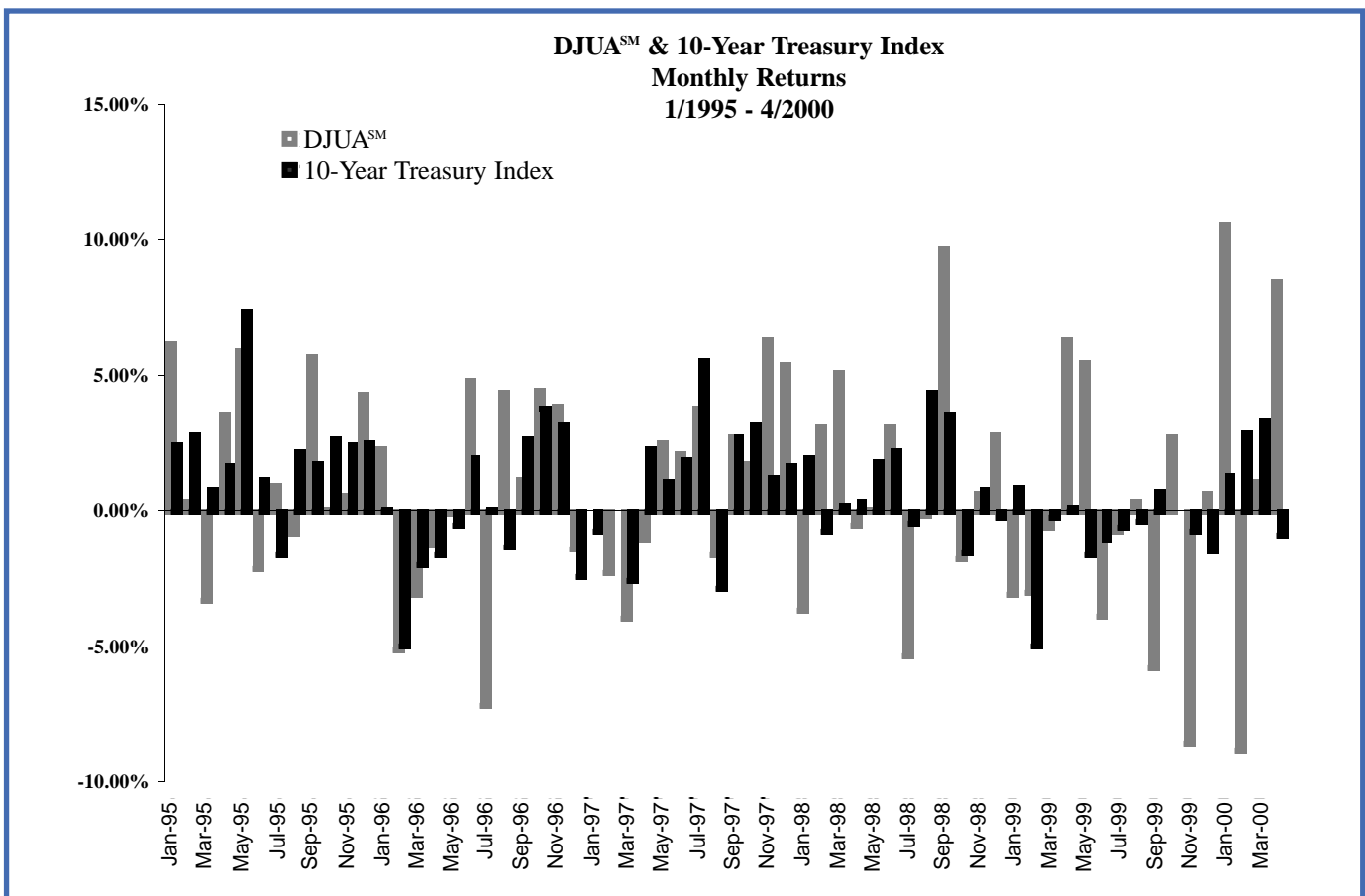
Summarizing the trade sequence:

September 8:	buy 1 December CBOT® DJTA SM futures contract	2,850
October 25:	sell (offset) 1 December CBOT® DJTA SM futures contract	3,025
Resulting gain, index points:		175
Resulting gain, dollar value:		$175 \times \$20 = \$3,500$

If your energy outlook had called for an increase in energy prices, you could just as easily have sold (gone short) one December CBOT® DJTASM contract. That way, you would have gained when the transportation index level dropped in response to the higher energy costs.

The Dow Jones Utility AverageSM

The Dow Jones Utility AverageSM (DJUASM) tracks the performance of 15 utility companies—among them Edison International, Enron, and Reliant Energy (see table on page 8 for a complete listing). Interest rates strongly influence the profitability of utilities because of the capital-intensive nature of this business. As borrowing costs increase, profits suffer and utility stock prices tend to drop. Conversely, as borrowing costs ease, profits grow and utility stock prices tend to rally, as the following chart shows.



Looking at recent economic data, such as unemployment numbers or the Consumer Price Index (CPI), you might conclude that inflationary pressures are building in the economy and that the U.S. Federal Reserve Board will tighten policy. By raising its fed funds target rate, the Fed will drive up the cost of credit to slow the growth of inflation.

Suppose that on December 15, the March CBOT® DJUASM futures contract is trading at 330. With each index point worth \$200 (that is, the index multiplier is \$200), one contract has a cash equivalent value of \$66,000 ($330 \times \$200 = \$66,000$). Expecting the Fed to increase its target rate, you can sell 3 March CBOT® DJUASM futures at 330.

By February 1, the Fed might have boosted its fed funds target twice, each time by 25 basis points. Because of the resulting higher borrowing costs, March CBOT® DJUASM futures might be trading at 315. At this point, you can offset your short position by buying 3 March CBOT® DJUASM futures. This 15-point drop in the index generates a \$9,000 gain for your futures position (before allowing for transaction costs).

Summarizing the trade sequence:

December 15: sell 3 March CBOT® DJUA SM futures	330
February 1: buy (offset) 3 March CBOT® DJUA SM futures	315
Resulting gain, index points:	15
Resulting gain, dollar value:	$15 \times \$200 \times 3 = \$9,000$

Had your initial research suggested interest rates were going to fall, you might have concluded the DJUASM was going to rally. In this case, you might have bought CBOT® DJUASM futures.

The CBOT web site offers materials that can support individual investors' trading decisions. Please visit www.cbot.com for more information.

CBOT[®] Dow Jones Composite AverageSM

DJIASM Stocks

Alcoa
American Express
AT&T
Boeing
Caterpillar
Citigroup
Coca-Cola
DuPont
Eastman Kodak
Exxon Mobil
General Electric
General Motors
Hewlett-Packard
Home Depot
Honeywell International
Intel
International Business
Machines
International Paper
J.P. Morgan
Johnson & Johnson
McDonald's
Merck
Microsoft
Minnesota Mining &
Manufacturing
Philip Morris
Procter & Gamble
SBC Communications
United Technologies
Wal-Mart Stores
Walt Disney

DJTASM Stocks

Airborne Freight
Alexander & Baldwin
AMR
Burlington Northern
Santa Fe
CNF Transportation
CSX
Delta Air Lines
FedEx
GATX
J.B. Hunt
Norfolk Southern
Northwest Airlines
Roadway Express
Ryder System
Southwest Airlines
UAL
Union Pacific
US Airways
USFreightways
Yellow

DJUASM Stocks

AES Corp.
American Electric Power
Consolidated Edison
Dominion Resources
Duke Energy
Edison International
Enron
Exelon Corp.
NiSource Inc.
PG&E Corp.
Public Service Enterprise
Group
Reliant Energy
Southern
TXU Corp.
Williams



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“Dow JonesSM,” “The DowSM,” “Dow Jones AveragesSM,” “Dow Jones Industrial AverageSM,” “DJIASM,” “Dow Jones Transportation AverageSM,” “DJTASM,” “Dow Jones Utility AverageSM,” “DJUASM,” “Dow Jones Composite AverageSM,” and “DJCASM” are service marks of Dow Jones & Company, Inc. and have been licensed for use for certain purposes by the Board of Trade of the City of Chicago (CBOT[®]). The CBOT futures and futures options contracts based on the Dow JonesSM Averages are not sponsored, endorsed, sold, or promoted by Dow JonesSM, and Dow JonesSM makes no representation regarding the advisability of trading in such products.

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