

S | X | MTM

Mini Futures Contracts
on the S&P/TSX 60TM Index

SXM

Index Arbitrage Using SXM Futures

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What is Arbitrage?

- The simultaneous buying and selling of securities, currencies, or commodities in different markets or in derivative structure.
- Traders looking to take advantage of a discrepancy in price for the same asset.

Arbitrage Opportunity

- A trader observes a disparity between the fair value of the SXM futures and the S&P/TSX 60 Index.
- Is looking to profit from the arbitrage opportunity.

Details

S&P/TSX 60 Index	808.20
Futures	806.50
Theoretical futures price	805.45
Fair value	-1.05
Dividends (index points)	4.48
Risk free rate	0.93%
Days to expiration	84

Strategy

- The trader wishes to profit from the mispriced futures.
- Trader borrows funds and purchases the underlying stocks that comprise the index.
- Sells the overpriced SXM futures.

The Trade

- Sell 100 x SXM futures contracts at 806.50.
- Buy 100 x 50 x 808.20 = \$4,041,000.00 of the underlying securities.
- The trade can be carried till expiration.

Cash Leg of Arbitrage

- On expiry, the SXM futures contract and the cash index converge at 820.05.
- Trader sells underlying stocks for a profit of 14.60 points (820.05 – 808.45).
- Fair value of index reflects cost of buying the stocks less the carrying costs.

Futures Leg of the Trade

- SXM cash settles at expiry at 820.05.
- The result is a 13.55 point loss (820.05 – 806.50).

Profit/Loss from the Arbitrage

- Profit of 1.05 index points (14.60 – 13.55).
- 1.05 points x \$50.00/point x 100 contracts = \$5,250.00
- A profit is realized with no significant risk to the market.

Summary

- Arbitrage ensures that the futures and the cash index trade in unison.
- If there is a discrepancy in price, it represents an opportunity to profit for arbitrage traders.