

Trading STIR Futures: *An Introduction to Short-Term Interest Rate Futures*

by Stephen Aikin

Reviewed by Jason Rolf

■ Liquidity, liquidity, liquidity... if ever there was a mantra for the financial markets then this would be it and the Short-Term Interest Rate (STIR) market could well be the flagship of all the products. This market has become one of the most important in the world as we see debt levels reach record levels. With access to these products becoming easier by the day, individuals are now able to enter a domain once populated only by institutions, banks and a few wealthy individuals.

"Trading STIR Futures – An Introduction to Short-Term Interest Rate Futures" by Stephen Aikin neatly bridges the gap between existing books that are either too highbrow and require a PhD in mathematics or are just too plain simple to provide any real knowledge of one of the biggest financial markets in the world. The author has nearly 20 years of plying his trade in the STIR market, from London to Sydney and back again. From the colourful open-outcry pits of late 20th century London to the relatively silent world of computerisation, and in this book one gets the feeling that he is keen to offer up this experience to new and old traders alike.

The book starts with the basics of STIR futures and what affects their pricing. The math is gentle and avoids over-succinct notation, and yet more advanced concepts such as advanced pricing, convexity,

and good old arbitrage are clearly explained. Although it never diverges too far from the basic idea of getting to grips with STIR trading outright, these peripheral trading techniques (mostly used by banks I should add) are all cogs that help bring the STIR market alive.

Even novice traders would probably already know how they would set themselves up for trading and the costs and capital that this involves. Even so, there is a full section on this and despite the temptation to skip, it actually provided some good up to date information on the latest evolution of trading software including price injection models and auto-trading facilities with "black-box" type functionality.

The main part of the book deals with the actual trading of the STIR futures and, I suspect, will be the foremost reason for anyone to want to buy it. Real-life trading examples are given throughout together with clear historical graphs and explanations of how trading decisions were arrived at and the author even provides information on ratios and various other valuable nuggets of information that would usually require access to Bloomberg or Reuters. We are guided through methods of outright trading to the high turnover, low margin world of spreading. Intra contract spreading will be of most appeal to readers, whereby the trader is looking for the smallest of discrepancies between prices along the curve, adding liquidity along the way. It is

this part of the business that has boosted volumes over the last few years as arcades full of trainee (and professional) traders have been established to try and capitalise on this relatively low risk way of trading the markets. The author describes all the various combinations of spreads that are required knowledge in order to actively trade the STIRs, including strips, packs, bundles and stacks. Weight is also given to the transaction costs of executing multi-leg spreads like these, an important point to consider, as this will be by far the greatest overhead for these transactions.

There will be a lot of traders who also wish to understand more about the inter-contract spread market that can be done between different STIR contracts and bond futures, for example European STIR futures versus Eurex bond futures or US STIR futures versus CBOT bond futures. Again, we are given easy to follow maths to show how hedging ratios and prices can be worked out in tabular format – all easily calculable in an Excel spreadsheet. What I really like about the examples in this book is that they all include dates of when they happened and the decisions made in order to profit from the opportunity that was present at that particular time. This section of the book is nicely rounded off with a thorough explanation of the spreading opportunities of STIR futures versus swap futures. In a nutshell, these instruments are based on the massive OTC (Over-The-Counter, basically agreements directly between banks) but allow traders to eliminate the majority of credit risk associated with trading bond futures versus STIRs. These are certain to become more mainstream as traders become better educated and look for better ways to spread their risk.

No book on trading would be complete without at least the briefest of mentions of technical analysis. Although I am a believer in using this to make trading decisions, I think that they only form part of the whole picture. Keeping to the basics is enough, and here the author has carefully selected just the right amount of exposure to what is required. Technical analysis is a huge subject and the major indicators are here together with good, clear historical examples. Another part of a trader's repertoire would include fundamental analysis, especially

Book Info

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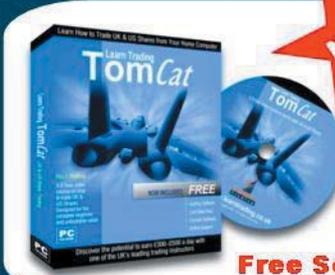
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important considering how every nuance of central banker's speeches are monitored and their instantaneous effect on the short-term rates and again this is comprehensively covered.

The book ends with a pleasant surprise; a fictional account of a STIR trader's "day in the office" and one can only presume this may be the author himself. Traders new and old will find this chapter not only informative, but also a lot of fun and is a great description of what the job entails. It is a lot of work to become proficient (let alone profitable) in any career, least of all one that pertains to be somewhat "enjoyable", but even so there will be many that decide to take this route and I reckon this book will inspire some to do exactly that.

To summarise, this book wears two hats. Firstly, it can be a good introduction, balanced to keep the layman interested enough to get a feel for what is involved in STIR trading and how this piece of the financial jigsaw fits in with other products. Secondly, it would serve as a good reference book when required. The STIRs market has matured almost to the point of congestion in the last few years, mostly as a result of the large numbers of participants looking to profit directly from arbitrage or pricing anomalies for want of a better term, a victim of its own success as it were. But this should not be construed as a negative for traders wishing to learn techniques both old and new, and it is books like this that can only push the boundaries of what is possible.

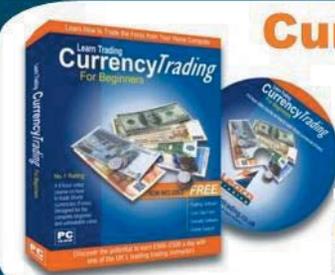
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