

INVESTOR'S EDGE

Profiting during uncertain times

Derivatives firm CME Group thrives on volatility

"For the investor who knows what he is doing, volatility creates opportunity."
— John Train, author of "Money Masters of Our Time:



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Since the bear market low reached in March 2009, stocks, as measured by the S&P 500 Index, have risen a remarkable 400%. Volatility, however, has hovered near record lows. In other words, the gains for investors on the overall U.S. stock market have not only been powerful but, shall we say, comfortable.

I don't mean to put a damper on things, but here's the truth: all things — including record-setting bull markets — must end. And considering the Dow Jones Industrial Average has risen from 6,600 in 2009 to 29,000 in 2019, a 340% increase, it might be wise to prepare your portfolio for a tougher, more volatile slog ahead.

As yields on both cash and most bonds are quite paltry, here's a shrewd way to get some cover from a potential bumpy ride ahead: CME Group (ticker symbol: CME). CME Group is a world-class, growing business that actually profits off of uncertainty and, most importantly, market volatility.

Using a recent example, in the fourth quarter of 2018, the S&P 500 Index dropped 14% (at one point the Dow was actually down 20%, peak to trough). Over that same timeframe, however, CME Group stock actually rose more than 12%, thriving off intense market swings.

As I write this, the Dow Jones Industrial Average is down more than 450 points because of fears of the spreading coronavirus, yet CME Group is up nearly 2%!

Okay, great, you may say, but exactly what service does CME Group provide?

CME Group is the world's largest derivatives marketplace and clearinghouse, averaging about 20 million individual contracts per day and taking in over \$4 billion in annual revenue. Basically, derivatives are financial instruments such as options (puts and calls) and futures contracts, which give buyers the right to trade certain assets at specific prices.

Derivatives are used mostly by sophisticated institutions, raw material and agricultural producers, and individual investors to hedge risk. CME Group allows customers to trade derivative positions across a variety of global asset types and commodities including interest rates, equity indices, currencies, livestock, precious metals, energy and more.

In simple terms, CME Group is an exchange that goes beyond traditional stock and bond investing to include risk-reducing financial instruments. Hence, during times of economic distress, fear, or just general market volatility, CME Group experiences greater demand for its risk management tools and also sees higher trading volumes across all of its various offerings. The stock has been a winner over the long term and has outperformed the S&P 500's return the last 3, 5, 10, and 15 years.

CME Group operates a relatively low-cost, asset-light business of which it controls a whopping 90% of the global market share for global futures trading and clearing. The company has a consistent track record of growing its earnings per share and is expected to experience double-digit revenue growth for 2020.

While derivatives are relatively well-known financial instruments here in the United States, they are not as widely used in much of the developing world. As emerging economies around the world become wealthier, their financial systems will become more sophisticated, likely leading them to adopt a greater use of derivative strategies.

In fact, in their most recent earnings report, CME Group reported 40% growth in international activity.

CME Group pays about a 1.5% dividend yield and has grown its dividend rate 50% over the last five years. Additionally, CME Group usually gives its shareholders a holiday gift every December via a special dividend; this year paying out an extra \$2.50 per share, almost doubling their standard payout.

If you believe that financial markets globally will continue to evolve over the next decade (almost a certainty) and that stock market volatility will return to normalized rates (a high probability), CME Group could be an excellent long-term addition to your investments. Buy it, and sleep well.

Jim Burns, a chartered financial analyst, is president of J.W. Burns & Co. The opinions expressed here are his and do not necessarily reflect those of The Post-Standard. Readers should do research before deciding on an investment. Contact him at jburns@jwburns.com

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