

New Futures Contract Empowers Investors to Gain or Hedge Exposure to Semiconductor Subsector

Semiconductors, or computer chips, have attracted much attention lately. Nowadays, they power a wide array of products and devices, which are becoming more interconnected through the internet of things. Further, the lockdowns during the COVID-19 pandemic sparked a huge surge in demand for laptops and other electronic devices, causing a major shortage in the chip supply – a problem widely reported in the media and felt by consumers worldwide.

From an equities market perspective, Nasdaq's PHLX Semiconductor Sector IndexSM (SOXSM) has become one of the best-known and most widely tracked subsector indexes in the technology sector. Market participants not only invest in the underlying stocks in this industry but also ETFs that track SOX. Now they are also empowered to manage their exposure using the new CME Group E-mini PHLX Semiconductor Sector futures contract (ticker: SOX).

"Our partnership with CME Group continues to provide more choice and versatility for investors looking to manage risk and meet their investment objectives," says Sean Wasserman, Vice President, Global Head of Index & Advisor Solutions at Nasdaq. "As with our existing futures contracts, we're excited for the launch of the SOX futures and value the important role CME Group plays in the investment community."

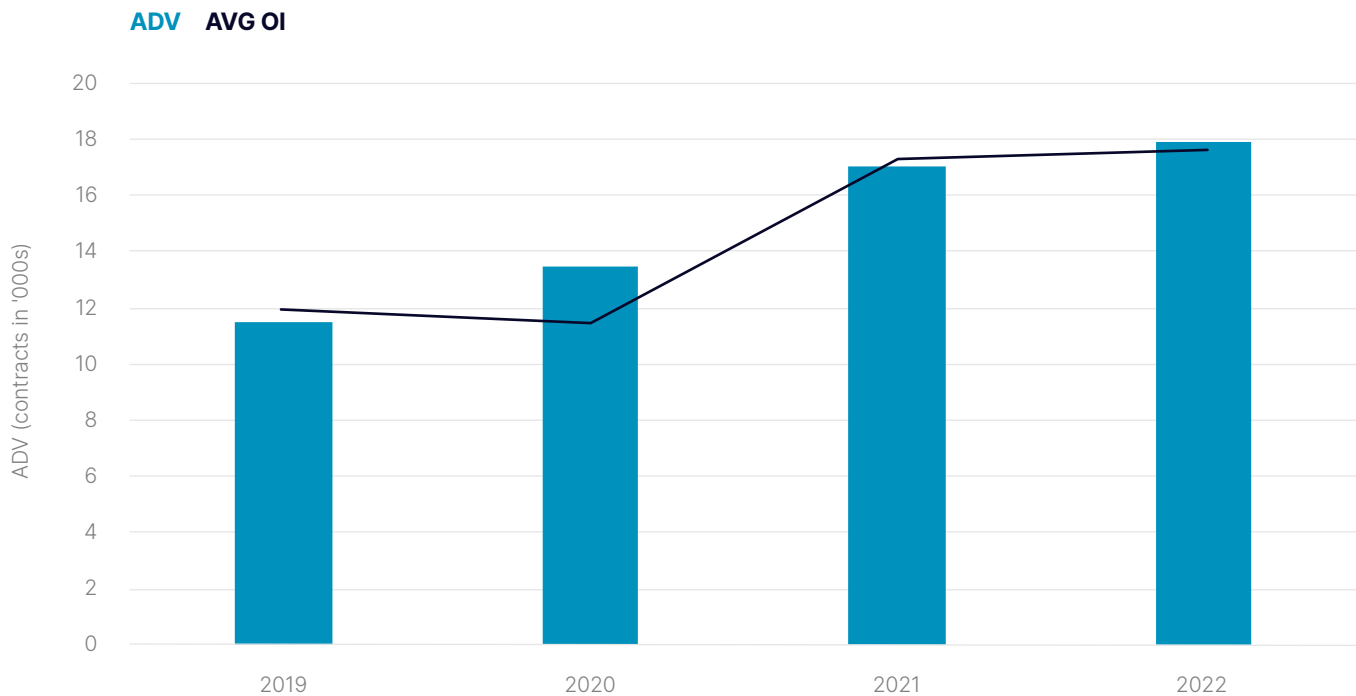
Nasdaq's SOX index comprises companies primarily involved in the design, distribution, manufacture and sale of semiconductors, including the top 30 securities by market capitalization in the semiconductor industry with US listings. The top 10 holdings are Texas Instruments (TXN), Intel (INTC), Broadcom (AVGO), Nvidia (NVDA), Advanced Micro Devices (AMD), Qualcomm (QCOM), KLA Corporation (KLAC), Analog Devices (ADI), Taiwan Semiconductors (TSM) and ASML (ASML). The index is modified market cap-weighted (8% capping for the top five constituents, with the rest capped at 4%) on a quarterly rebalancing schedule. Constituents must have a listing in the U.S. on either the Nasdaq, NYSE, or CBOE exchanges. They are also required to meet minimum thresholds for market cap (\$100 million) and liquidity (1.5 million shares traded in each of the last six months).

According to Paul Woolman, Executive Director – Head of EMEA Equity and Alternative Index Products at CME Group, sector dispersion is a key use case for the SOX futures contract. At any given time, broad market indexes such as the S&P 500, Russell 2000 or Nasdaq-100 may be trending in one direction. However, some sectors within those indexes may be performing very differently to each other and can move in the opposite direction. This dynamic presents an opportunity to trade one sector against another sector, a sector against a broad index or a sector against one or more stocks in the sector.

“You’re expecting one sector to outperform or underperform the other exposure, depending on your view,” he explains. “In addition to this relative value trading opportunity, sector futures also provide the ability for clients to go long or short in order to express a directional view, to put on an overlay strategy or to risk manage a specific sector within their portfolio. These are all potential user cases for the new E-mini PHLX Semiconductor Sector futures.”

To this end, it is not surprising that sector-based futures volumes and the number of participants using the contracts have increased, with average daily volume up 56% since 2019. The main users are asset managers, pension funds, insurance companies and hedge funds who use the contracts typically for one of the use cases described above. Market makers and proprietary trading firms help to provide liquidity on the central limit order book whilst banks facilitate access to these contracts on behalf of their clients, and provide both block and on-screen liquidity.

CME Group Sector Futures ADV and Open Interest



Data through 6/30/2022

Source: CME Group

As of August 8, 2022, SOX futures may be traded on screen or as outright blocks. [Block trades](#) are privately negotiated transactions that meet certain quantity thresholds and are permitted to be executed apart from the public auction market.

However, sometimes the block quantity may be too large and require a longer reporting period to allow the counterparties to hedge their exposure. As such, SOX futures are eligible for derived block trading, like the other 18 [sector-based Equity Index futures contracts](#) listed at CME Group. A derived block is a block trade consummated by eligible contract participants in which the price and quantity of the trade depends on hedging transactions in an eligible related market. Parties agree to the predefined notional or number of contracts and the market in which the hedging transaction will take place. Additionally, a basis price is agreed to be added to the index price of the resultant hedge in the related market. Permitted hedging instruments include stock baskets and other eligible related market instruments such as ETFs.

“Derived blocks allow market participants to source liquidity in the underlying stocks in the index or in ETFs that track the index and then transfer the liquidity into the futures contracts,” says Woolman.

Additionally, SOX futures are eligible for Basis Trade at Index Close (BTIC) under the ticker SOT. These transactions enable market participants to trade futures contracts at a fixed spread, or basis, relative to the official index cash close. Market participants may also migrate their existing exposure into the futures contract through an Exchange of Futures for Physical (EFP). This is a private agreement between two parties to trade a futures position for the basket of underlying stocks or an ETF. EFPs can be used to open or close a futures position or switch a futures position for the underlying asset.

SOX futures are cost-, capital- and tax efficient. Market participants can get exposure to the semiconductor subsector by putting up a small percentage of the notional amount as margin, which can be offset against positions in other products at CME Group. Under section 1256 of the U.S. tax code, profit and loss on these transactions are entitled to be taxed at a rate equal to 60% long-term and 40% short-term capital gain or loss. Finally, SOX futures are UCITS eligible, which is beneficial for EMEA-based investors.

CME Group has had great success partnering with Nasdaq on futures products. Woolman points out that the E-mini Nasdaq-100® Index (NDX®) futures contract is an important part of the equity ecosystem because the technology sector is a driver of equity markets and market cap. This is evidenced by the liquidity of the contract continuing to grow strongly over the last few years. Further, technology tends to be one of the more volatile sectors.

“Clients who like trading tactically, like to trade the Nasdaq-100,” he says. “SOX will have its own unique risk profile, and it will give clients greater choice.”

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