ENERGY FUTURES: TRADING OPPORTUNITIES FOR THE 1990S, (John Elting Treat ed., PennWell Books, 1990).

Reviewed by *Dr. Robert Weiner**

The timeliness of this book is reflected in its subtitle. After decades of relative tranquility, price stability, and virtually no open-market activity, the energy business, particularly petroleum, has undergone dramatic upheaval since the oil crisis of 1973. Salient here is the sea-change during the 1980s in the way energy products are bought and sold. Open markets, trading, volatile prices, and industry restructuring have made risk management a key element of success in the industry. Financial institutions have become major players and have introduced a host of new products designed to help companies manage risk in the new era of uncertainty.

In an industry where events have traditionally moved at glacial speed, these changes have been met with bewilderment and substantial resistance. Information sources have simply been unable to keep up with the pace of market developments. Several books on this subject appeared in the mid-1980s (including an earlier version of this one—see references). Since then, however, financial aspects of the energy business, including futures trading, have multiplied several fold in size and variety and the earlier works have become outdated rapidly. Moreover, in the second half of the 1980s and early 1990s there has been tremendous volatility in oil prices, increasing the usefulness of risk management to the petroleum industry and making an understanding of futures trading, and the role it plays in the industry, critical to those who work in the energy field.

This volume contains an edited collection of views from practitioners in the rapidly growing area of energy futures and options trading, a major element of risk management in the new era. The editor, John Elting Treat, was President of the New York Mercantile Exchange (NYMEX) at the time when the crude oil futures contract was introduced, 1982 to 1984. Already by far the world's largest non-financial market, crude oil became one of the largest futures markets as well by the end of the decade. Treat is in a unique position to reflect on the past, present, and outlook (the subject of his introductory chapter). The book is divided into eight, mostly single chapter, sections. The thirteen chapters were contributed by experts involved in designing and using energy futures contracts. The book concludes with over one hundred pages of appendices which set out the specifications for four contracts traded on the NYMEX and two contracts traded on the International Petroleum Exchange (IPE), a glossary of specialized futures terms, and useful addresses for further information.

The heart of the work, by far the largest section (comprising four chap-

* Professor, Brandeis University; Research Fellow in the International Energy Program Center for Business and Government at the JFK School of Government, Harvard University. Dr. Weiner's work as a Fellow focuses on international petroleum markets. He has also published three books and numerous articles on the financial aspects of oil markets.

ters, about half of the text), is entitled "Trading Theories and Strategies," and is aimed at the specialist in energy, rather than finance. The first chapter of the section, "Oil Market Fundamentals," introduces readers to the supply and demand factors that influence oil prices. "The Principles of Technical Analysis," the next chapter, exposes the reader to some of the standard techniques used by "chartists," speculators who try to forecast prices futures by extrapolating from patterns in the recent past, rather than on the basis of changes in fundamentals. Since each type of analysis can suggest different answers to similar questions, it would have been helpful if each of these chapters commented on the approach of the other chapter, or at least provided a way of comparing them in a common framework.

One of the fastest growing areas of risk management is options trading. Where the holder of a futures contract has the obligation to make delivery or to take delivery (the former obligation is associated with a "short" position in futures terminology, the latter with a "long" position) or to enter into an offsetting transaction, the holder of an option contract can choose to consummate the transaction (referred to as "exercising" the option) or throw the option away. The complexities of options trading are nicely described, with examples, in the next chapter, "Options Strategies." The final chapter of the section, "Development and Integration of Hedging Strategies," takes up the risk management process itself, discussing how it fits into the company's strategy. Taken together, the four chapters offer a solid introduction to the subject.

The remaining sections of the book present a grab bag of topics in the field. Likely to be of particular interest to readers of this journal are chapters on Natural Gas Trading and Futures, which developed out of the need to manage risk in a deregulated environment, and which started only in 1990; Accounting, Taxation, and Internal Control for futures and options; and Regulation of Energy Futures and Options Trading.

The subtitle also offers a clue to the book's perspective. This is not, for the most part, an analytical study. Many of the authors have been involved in the early success of energy futures and options trading and have an interest in its continued growth. In fact, some of the brief biographies in the introduction are written in the form of advertisements (one author is described as having a "reputation for uncanny accuracy") and cry out for editing. Other forms of risk management in the energy business are mentioned only in passing (forward markets) or not mentioned at all (oil-price swaps). Nor are the problems the industry has experienced with energy futures contracts raised or the fact that many such contracts have been successful.

Readers seeking analysis of how well energy futures markets work, and their effects on the industry, will need to look elsewhere (e.g., Dominguez et al., 1989, 1991). Nor will those looking for a quick, easy-to-read primer find one here. The subject is a complex one, and the authors sprinkle their exposition liberally with technical terms, charts, and tables, which are not easily digested in one gulp. Those in search of a good introduction and reference to the mechanics and institutions of energy futures contracts and trading will, in contrast, find this volume a useful addition to their reference shelf.