Futures

An Introduction

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through a regulated futures exchange. The parties agree to buy or sell an asset - livestock, a foreign currency, or some other item - at a certain time in the future at a mutually agreed upon price. Each futures contract specifies the quantity and quality of the item, expiration month, the time of delivery and virtually all the details of the transaction except price, which the two parties negotiate based on current market conditions. Some futures contracts call for the actual, physical delivery of the underlying commodity or financial instrument at contract termination. Others simply call for a cash settlement at contract termination. Generally, however, market participants do not hold their futures contracts until termination but rather offset futures contracts they have bought ("gone long") by a subsequent sale; or, offset futures contracts they have sold ("gone short") by a subsequent purchase.

Futures contracts are also called derivatives, because their value is derived from the market value of the underlying commodity or financial instrument on which the contracts are based. Futures traded on exchanges regulated by governmental agencies may be distinguished from derivatives traded over-the-counter.

In broadest terms, futures are about anticipated future prices of basic commodities and financial instruments, based on current information. Futures are concerned with such questions as what will the price of cattle be next December? What will interest rates be in six months? How much will a euro be worth in May?

Because commodity prices are constantly changing, virtually all businesses face ongoing price risk. Meat processors face risk from fluctuating cattle prices, lenders from changing interest rates, and international businesses from varying currency rates. All these businesses can use futures to help manage their exposure to price risk. Futures prices increase and decrease largely because of the myriad factors that influence buyers' and sellers' judgments about what a particular commodity will be worth at a given time in the future (anywhere from less than a month to more than two years).

As new supply and demand developments occur and as new and more current information becomes available, these judgments are reassessed and the price of a particular futures contract may be bid upward or downward. The process of reassessment--of price discovery--is continuous.

Thus, in January, the price of a July futures contract would reflect the consensus of buyers' and sellers' opinions at that time as to what the value of a commodity or item will be when the contract expires in July. On any given day, with the arrival of new or more accurate information, the price of the July futures contract might increase or decrease in response to changing expectations.

Competitive price discovery is a major economic function--and, indeed, a major economic benefit--of futures trading. The trading floor of a futures exchange is where available information about the future value of a commodity or item is translated into the language of price. In summary, futures prices are an ever changing barometer of supply and demand and, in a dynamic market, the only certainty is that prices will change.

Futures contracts – price agreements – are bought and sold in what is basically a marketplace of opportunity for two symbiotic groups: hedgers, who seek to offset price risk, and speculators, who try to make a profit from favorable price fluctuations. Hedgers are typically businesses and financial institutions who buy and sell futures contracts seeking to “lock in” future prices for commodities that are essential to their business operations. Speculators are a diverse group that includes day traders, financial institutions such as banks and hedge funds, and arbitragers. These groups are brought together at a futures exchange, which provides a venue where their orders may interact on a trading floor or a computer network, and where price agreements can be negotiated.

Traders’ decisions generally aren’t random, but are based on a synthesis of a great deal of data and a variety of different strategies. Some people make trading decisions based on fundamental analysis of the forces of supply and demand in a commodity market (“fundamental analysis”); others trade based on an analysis of market trends and price chart patterns (“technical analysis”).

Because futures prices represent the aggregate of all available information that may affect the market, they are viewed as reflecting a process of “price discovery.” Prices change constantly in response to numerous factors, ranging from weather and wars to political decisions and popular trends. The futures markets assimilate that information and provide a means of determining the price above which buyers will not buy and below which sellers will not sell – the “equilibrium” price – where the supply to be sold and the demand to buy are in balance. The price of futures and the underlying cash markets on which futures are based tend to come together or “converge” by contract expiration. The price of a futures contract at expiration and the cash (“spot”) price of the underlying asset must be the same, because both refer to the same asset are basically equivalent, because both prices refer to the same asset.

In simplest terms, futures trading is simply the buying and selling of futures contracts. You can find out how it all works, who trades these instruments, and the differences between electronic and floor trading in the following sections.

Futures Exchanges in the U.S. and Abroad

A futures exchange, legally known in the U.S. as a “designated contract market,” is, at its core, an auction market – highly regulated, technical and complex – but an auction market nonetheless.

A futures exchange is the only place where futures and options on futures (which offer the right, but not the obligation, to buy or sell an underlying futures contract at a particular price) can be traded. Trading may take place either on the exchange’s trading floor or via an electronic trading platform. An exchange itself does not trade futures. Instead, it:

- Provides and maintains the facilities where buyers and sellers meet, ranging from traditional “trading pits” to global electronic trading networks
- Researches, develops and offers futures contracts to be traded
- Oversees the trading of its products and enforces trading-related rules and regulations
- Monitors and enforces financial and ethical standards
- Provides daily and historical data on the contracts traded under its auspices

Futures exchanges in the U.S. are subject to a great deal of regulation. They are monitored by the Commodity Futures Trading Commission (CFTC) and the National Futures Association (NFA). In addition, most futures exchanges practice intense self-regulation, monitoring their employees and the trading practices that occur in their facilities.

These agencies look after the public interest, ensure fair practice and monitor the process of price discovery that occurs in futures trading. Other governmental bodies, including the Securities and Exchange Commission, the Federal Reserve Board, and the U.S. Treasury Board also monitor some futures exchange functions. Violations of exchange rules can result in substantial fines, as well as suspension or revocation of trading privileges.

There are currently 13 futures exchanges registered in the U.S. but not all are hosting active trading. CME is the largest futures exchange in the U.S. by volume, and the first U.S. futures exchange to become a for-profit corporation, after revising its original private membership structure and a becoming publicly traded company in 2002. Most U.S. exchanges remain not-for-profit, private membership organizations, but a number of them are actively weighing the advantages of changing to stock corporations.
There are more than 50 futures exchanges worldwide, and they are structured in a number of different ways. Some futures exchanges are owned by groups of

banks or by a stock exchange holding company. Other exchanges, or their holding companies, are publicly listed on a stock exchange, similar to CME.

How Futures Exchanges Earn Income

Since futures exchanges do not themselves engage in trading, people sometimes wonder how they earn money. Futures exchanges earn income primarily by:

- Receiving a fee for every trade made through the exchange.
- Selling price data – current, streaming price data in real time as well as historical
  price data on trades made through the exchange. At CME, data subscription services
  include CME E-quotes™ and CME E-history.
- Charging for clearing services, if the futures exchanges own their own clearing house, as is the case with CME. Some exchanges outsource the clearing function. The Chicago Board of Trade, for example, has its contracts cleared through the CME Clearing House.

People who trade futures can, in most cases, be very broadly classified as hedgers or speculators.

Hedgers

Hedgers are looking for some measure of price certainty. Commodity hedgers – people who trade agricultural products, energy products or metals, for example – typically are involved in commercial interests that either produce, process or utilize the commodity they are trading. Hedgers of financial futures are typically in businesses that depend upon interest rates, foreign exchange rates, or stock index levels, such as banking or pension fund management.

Cattle ranchers, for example, may fear that cattle prices will decline before they bring their animals to market. To protect themselves, they decide to sell futures on live cattle that will expire at approximately the same time they expect to deliver their cattle to the market, and at the price they are hoping to get in the cash market. If cattle prices do go down, the ranchers can still make money on their futures positions, that will hopefully offset the reduced price they receive for their cattle.

Speculators

Speculators trade futures with the objective of making a profit by being on the right side of a price move. Since the prices of commodities and financial instruments tend to change frequently, at least in certain markets, trading opportunities can be numerous.

Speculators can be categorized into several broad groups: scalpers, day traders, position traders, arbitragers, and people seeking exposure to certain markets.

Scalpers typically trade for a small profit on any single trade and therefore often trade continuously, seeking to make as many small gains as possible. In so doing, they create liquidity – the presence of enough people in the market so that market participants, notably hedgers, can buy and sell quickly and in large volume without substantially impacting prices. Scalpers' frequent trades increase the trading possibilities available to others, and help provide the liquidity that is essential to the existence of futures markets.

Other speculators include day traders, who typically make one or two trades per day, and position traders, who tend to hold contracts for days, weeks or months, depending on market factors.

And finally, arbitragers are speculators who watch the relative value of multiple markets closely and step in to trade whenever momentary price discrepancies appear. By keeping prices in line for the same product trading on different exchanges, arbitragers lend stability to the price negotiation process.

Floor Traders

Persons known as floor traders or locals, who buy and sell for their own accounts on the trading floors of the exchanges, are the least known and understood of all futures market participants. Yet their role is an important one. Like specialists and market makers at securities exchanges, they help to provide market liquidity. If there isn't a hedger or another speculator who is immediately willing to take the other side of your order at or near the going price, the chances are there will be an independent floor trader who will do so, in the hope of minutes or even seconds later being able to make an offsetting trade at a small profit. In the grain markets, for example, there is frequently only one-fourth of a cent a bushel difference between the prices at which a floor trader buys and sells.

Floor traders, of course, have no guarantee they will realize a profit. They may end up losing money on any given trade. Their presence, however, makes for more liquid and competitive markets. It should be pointed out, however, that unlike market makers or specialists in securities markets, floor traders are not obligated to maintain a liquid market or to take the opposite side of customer orders.

Trading Venues

Most U.S. futures exchanges offer two venues for trading: the traditional floor-trading venue and electronic trading. Broadly speaking, trading is essentially the same in either format: Customers submit orders that are executed – filled – by other traders who take equal but opposite positions, selling at prices at which other customers buy or buying at prices at which other customers sell. This matching of buyers and sellers occurs in both open outcry and electronic trading, but there are some differences between the two processes.

In open outcry trading, orders are communicated to brokers in a trading pit, via requests that customers make to their brokerages by phone or computer. Customer bids and offers are presented by pit brokers to other brokers standing in the pit, and trades are "executed" – matches are made – when prices that are mutually acceptable to buyers and sellers are identified. Customers are notified of their trades, information about each trade is sent to the clearing house and brokerages, and prices are disseminated immediately throughout the world. The trade order is also time-stamped at both ends of the process.

In electronic or screen-based trading, customers send buy or sell orders directly from their computers to an electronic marketplace offered by the exchange. There is no need to have brokers submit and execute orders for customers, because the customers will have received brokerage approval to trade electronically, and the exchange computer system informs the brokerages of customer activity. In a sense, the trading screen replaces the trading pit, and the electronic market participants replace the brokers standing in the pit.

There is greatly expanded price transparency because the top five current bids and offers are posted on the trading screen for all market participants to see – an advantage that even brokers in a pit don't have.

The exchange computer system keeps track of all trading activity, and identifies matches of bids and offers, with fills generally made according to a first-in, first-out (FIFO) process, although some alternate allocation processes are used in particular markets. Trade information is sent to the clearing house and brokerage, and prices are also instantaneously broadcast to the public. Trades made on CME Globex®, for instance, are typically completed in a fraction of a second. In open outcry trading, however, it can take from a few seconds to minutes to execute a trade, according to the complexity of the order.

After the Closing Bell

Once a closing bell signals the end of a day's trading, the exchange's clearing organization matches each purchase made that day with its corresponding sale and tallies each member firm's gains or losses based on that day's price changes--a massive undertaking considering that nearly two-thirds of a million futures contracts are bought and sold on an average day. Each firm, in turn, calculates the gains and losses for each of its customers having futures contracts.

Gains and losses on futures contracts are not only calculated on a daily basis, they are credited and deducted on a daily basis. Thus, if a speculator were to have, say, a $300 profit as a result of the day's price changes, that amount would be immediately credited to his brokerage account and, unless required for other purposes, could be withdrawn. On the other hand, if the day's price changes had resulted in a $300 loss, his account would be immediately debited for that amount.

The process just described is known as a daily cash settlement and is an important feature of futures trading. As will be seen when we discuss margin requirements, it is also the reason a customer who incurs a loss on a futures position may be called on to deposit additional funds to his account.

The Arithmetic of Futures Trading

To say that gains and losses in futures trading are the result of price changes is an accurate but by no means complete explanation. Perhaps more so than in any other form of speculation or investment, gains and losses in futures trading are highly leveraged. An understanding of leverage--and of how it can work to your advantage or disadvantage--is crucial to an understanding of futures trading.

As mentioned above, the leverage of futures trading stems from the fact that only a relatively small amount of money (known as initial margin) is required to buy or sell a futures contract. On a particular day, a margin deposit of only $1,000 might enable you to buy or sell a futures contract covering $25,000 worth of soybeans. Or for $10,000, you might be able to purchase a futures contract covering common stocks worth $260,000. The smaller the margin in relation to the value of the futures contract, the greater the leverage.

If you speculate in futures contracts and the price moves in the direction you anticipated, high leverage can produce large profits in relation to your initial margin. Conversely, if prices move in the opposite direction, high leverage can produce large losses in relation to your initial margin. Leverage is a two-edged sword.

For example, assume that in anticipation of rising stock prices you buy one June S&P 500 stock index futures contract at a time when the June index is trading at 1000. And assume your initial margin requirement is $10,000. Since the value of the futures contract is $250 times the index, each 1 point change in the index represents a $250 gain or loss.

Thus, an increase in the index from 1000 to 1040 would double your $10,000 margin deposit and a decrease from 1000 to 960 would wipe it out. That's a 100% gain or loss as the result of only a 4% change in the stock index!

Stated another way, while buying (or selling) a futures contract provides exactly the same dollars and cents profit potential as owning (or selling short) the actual commodities or items covered by the contract, low margin requirements sharply increase the percentage profit or loss potential. For example, it can be one thing to have the value of your portfolio of common stocks decline from $100,000 to $96,000 (a 4% loss) but quite another (at least emotionally) to deposit $10,000 as margin for a futures contract and end up losing that much or more as the result of only a 4% price decline. Futures trading thus requires not only the necessary financial resources but also the necessary financial and emotional temperament.

Trading

An absolute requisite for anyone considering trading in futures contracts--whether it's sugar or stock indexes, pork bellies or petroleum--is to clearly understand the concept of leverage as well as the amount of gain or loss that will result from any given change in the futures price of the particular futures contract you would be trading. If you cannot afford the risk, or even if you are simply uncomfortable with the risk, the only sound advice is don't trade. ***Futures trading is not for everyone.***

Margins

As is apparent from the preceding discussion, the arithmetic of leverage is the arithmetic of margins. An understanding of margins--and of the several different kinds of margin--is essential to an understanding of futures trading.

If your previous investment experience has mainly involved common stocks, you know that the term margin--as used in connection with securities--has to do with the cash down payment and money borrowed from a broker to purchase stocks. But used in connection with futures trading, margin has an altogether different meaning and serves an altogether different purpose.

Rather than providing a down payment, the margin required to buy or sell a futures contract is solely a deposit of good faith money that can be drawn on by your brokerage firm to cover losses that you may incur in the course of futures trading. It is much like money held in an escrow account.
Minimum margin requirements for a particular futures contract at a particular time are set by the exchange on which the contract is traded. They are typically about five percent of the current value of the futures contract. Exchanges continuously monitor market conditions and risks and, as necessary, raise or reduce their margin requirements. Individual brokerage firms may require higher

margin amounts from their customers than the exchange-set minimums.

There are two margin-related terms you should know: initial margin and maintenance margin.

Initial margin (sometimes called original margin) is the sum of money that the customer must deposit with the brokerage firm for each futures contract to be bought or sold. On any day that profits accrue on your open positions, the profits will be added to the balance in your margin account. On any day losses accrue, the losses will be deducted from the balance in your margin account.

If and when the funds remaining available in your margin account are reduced by losses to an amount below a certain level--known as the maintenance margin requirement--your broker will require that you deposit additional funds to bring the account back to the level of the initial margin. Or, you may also be asked for additional margin if the exchange or your brokerage firm raises its margin requirements. Requests for additional margin are known as margin calls.

Assume, for example, that the initial margin needed to buy or sell a particular futures contract is $2,000 and that the maintenance margin requirement is $1,500. Should losses on open positions reduce the funds remaining in your trading account to, say, $1,400 (an amount less than the maintenance requirement), you will receive a margin call for the $600 needed to restore your account to $2,000.

Before trading in futures contracts, be sure you understand the brokerage firm's Margin Agreement and know how and when the firm expects margin calls to be met. Some firms may require only that you mail a personal check. Sometimes, the firm's requirements on a given margin call may be different than on others because of current market conditions. Others may insist you wire transfer funds from your bank or provide same-day or next-day delivery of a certified or cashier's check. In any case, if margin calls are not met in the prescribed time and form, the firm can protect itself, without further notice to you, by liquidating your open positions at the available market price (possibly resulting in an unsecured loss for which you would be liable).

Basic Trading Strategies

Even if you should decide to participate in futures trading in a way that doesn't involve having to make day-to-day trading decisions (such as a managed account or commodity pool), it is nonetheless useful to understand the dollars and cents of how futures trading gains and losses are realized. And, of course, if you intend to trade your own account, such an understanding is essential.

Dozens of different strategies and variations of strategies are employed by futures traders in pursuit of speculative profits. Here is a brief description and illustration of several basic strategies.

Buying (Going Long) to Profit from an Expected Price Increase; one who is expecting the price of a particular commodity or item to increase over from a given period of time can seek to profit by buying futures contracts. If correct in forecasting the direction and timing of the price change, the futures contract can later be sold for the higher price, thereby yielding a profit.* If the price declines rather than increases, the trade will result in a loss. Because of leverage, the gain or loss may be greater than the initial margin deposit.

For example, assume it's now January, the July soybean futures contract is presently quoted at $6.00, and over the coming months you expect the price to increase. You decide to deposit the required initial margin of, say, $1,500 and buy one July soybean futures contract. Further assume that by April the July soybean futures price has risen to $6.40 and you decide to take your profit by selling. Since each contract is for 5,000 bushels, your 40-cent a bushel profit would be 5,000 bushels x 40 cents or $2,000 less transaction costs.

		Price per bushel	Value of 5,000 bushel contract
January	Buy 1 July soybean futures contract	$6.00	$30,000
April	Sell 1 July soybean futures contract $6.40	$6.40	$32,000
	Gain	$ .40	$ 2,000

* For simplicity examples do not take into account commissions and other transaction costs. These costs are important, however, and you should be sure you fully understand them. Suppose, however, that rather than rising to $6.40, the July soybean futures price had declined to $5.60 and that, in order to avoid the possibility of further loss, you elect to sell the contract at that price. On 5,000 bushels your 40-cent a bushel loss would thus come to $2,000 plus transaction costs.

		Price per bushel	Value of 5,000 bushel contract
January	Buy 1 July soybean futures contract	$6.00	$30,000
April	Sell 1 July soybean futures contract	$5.60	$28,000
	Loss	$ .40	$ 2,000

Note that the loss in this example exceeded your $1,500 initial margin. Your broker would then call upon you, as needed, for additional margin funds to cover the loss.

Selling (Going Short) to Profit from an Expected Price Decrease; one who is expecting the price of a particular commodity or item to decrease over from a given period of time can seek to profit by selling futures contracts. The only way 'going short' to profit from an expected price decrease differs from 'going long' to profit from an expected price increase is the sequence of the trades. Instead of first buying a futures contract, you first sell a futures contract. If, as expected, the price declines, a profit can be realized by later purchasing an offsetting futures contract at the lower price. The gain per unit will be the amount by which the purchase price is below the earlier selling price. For example, assume that in January your research or other available information indicates a probable decrease in cattle prices over the next several months. In the hope of profiting, you deposit an initial margin of $2,000 and sell one April live cattle futures contract at a price of, say, 65 cents a pound. Each contract is for 40,000 pounds, meaning each 1 cent a pound change in price will increase or decrease the value of the futures contract by $400. If, by March, the price has declined to 60 cents a pound, an offsetting futures contract can be purchased at 5 cents a pound below the original selling price. On the 40,000 pound contract, that's a gain of 5 cents x 40,000 lbs. or $2,000 less transaction costs.

		Price per pound	Value of 40,000 pound contract
January	Sell 1 April live cattle futures contract	$.65	$26,000
March	Buy 1 April live cattle futures contract	$.60	$24,000
	Gain	$.05	$ 2,000

Assume you were wrong. Instead of decreasing, the April live cattle futures price increases--to, say, 70 cents a pound by the time in March when you eventually liquidate your short futures position through an offsetting purchase. The outcome would be as follows:

		Price per pound	Value of 40,000 pound contract
January	Sell 1 April live cattle futures contract	$.65	$26,000
March	Buy 1 April live cattle futures	$.70	$28,000
	Loss	$.05	$2,000

In this example, the loss of 5 cents a pound on the futures transaction resulted in a total loss of the $2,000 you deposited as initial margin plus transaction costs.

Spreads

While most speculative futures transactions involve a simple purchase of futures contracts to profit from an expected price increase--or an equally simple sale to profit from an expected price decrease--numerous other possible strategies exist. Spreads are one example. A spread, at least in its simplest form, involves buying one futures contract and selling another futures contract. The purpose is to profit from an expected change in the relationship between the purchase price of one and the selling price of the other. As an illustration, assume it's now November, that the March wheat futures price is presently $3.10 a bushel and the May wheat futures price is presently $3.15 a bushel, a difference of 5 cents. Your analysis of market conditions indicates that, over the next few months, the price difference between the two contracts will widen to become greater than 5 cents. To profit if you are right, you could sell the March futures contract (the lower priced contract) and buy the May futures contract (the higher priced contract). Assume time and events prove you right and that, by February, the March futures price has risen to $3.20 and May futures price is $3.35, a difference of 15 cents. By liquidating both contracts at this time, you can realize a net gain of 10 cents a bushel. Since each contract is 5,000 bushels, the total gain is $500.

November	Sell March wheat	Buy May wheat	Spread
	$3.10 Bu.	$3.15 Bu	5 cents
February	Buy March wheat	Sell May wheat	
	$3.20 Bu.	$3.35 Bu.	
	$.10 loss	$.20 gain	

Participating in Futures Trading

Now that you have an overview of what futures markets are, why they exist and how they work, the next step is to consider various ways in which you may be able to participate in futures trading. There are a number of alternatives and the only best alternative--if you decide to participate at all--is whichever one is best for you. Also discussed below is the opening of a futures trading account, the regulatory safeguards provided to participants in futures markets, and methods for resolving disputes, should they arise.

Deciding How to Participate

At the risk of oversimplification, choosing a method of participation is largely a matter of deciding how directly and extensively you, personally, want to be involved in making trading decisions and managing your account. Many futures traders prefer to do their own research and analysis and make their own decisions about what and when to buy and sell. That is, they manage their own futures trades in much the same way they would manage their own stock portfolios. Others choose to rely on or at least consider the recommendations of a brokerage firm or account executive. Some purchase independent trading advice. Others would rather have someone else be responsible for trading their account and therefore give trading authority to their broker. Still others purchase an interest in a commodity trading pool. There's no formula for deciding. Your decision should, however, take into account such things as your knowledge of and any previous experience in futures trading, how much time and attention you are able to devote to trading, the amount of capital you can afford to commit to futures, and, by no means least, your individual temperament and tolerance for risk. The last is important. Some individuals thrive on being directly involved in the fast pace of futures trading; others are unable, reluctant, or lack the time to make the immediate decisions that are frequently required. Some recognize and accept the fact that futures trading all but inevitably involves having losing trades. Others lack the necessary disposition or discipline to acknowledge that they were wrong on a particular occasion and liquidate the position. Many experienced traders thus suggest that, of all the things you need to know before trading in futures contracts, perhaps the most important is to know yourself. This can help you make the right decision about whether to participate at all and, if so, in what way. In no event, it bears repeating, should you participate in futures trading unless the capital you would commit is risk capital. That is, capital which, in pursuit of profits, you can afford to lose. It should be capital over and above that needed for necessities, emergencies, savings and achieving your long-term investment objectives. You should also understand that, because of the leverage involved in futures, the profit and loss fluctuations may be wider than in most types of investment activity and you may be required to cover deficiencies due to losses over and above what you had expected to commit to futures.

Trade Your Own Account

Trading your own account involves opening an individual trading account and--with or without the recommendations of the brokerage firm--making your own trading decisions. You will also be responsible for assuring that adequate funds are on deposit with the brokerage firm for margin purposes, or that such funds are promptly provided as needed. Practically all of the major brokerage firms you are familiar with, and many you may not be familiar with, have departments or even separate divisions to serve clients who want to allocate some portion of their investment capital to futures trading. All brokerage firms conducting futures business with the public must be registered with the Commodity Futures Trading Commission ("CFTC", the independent regulatory agency of the federal government that administers the Commodity Exchange Act) as Futures Commission Merchants ("FCM") or Introducing Brokers ("IB") and must be members of the National Futures Association ("NFA", the industry-wide self-regulatory association). Different firms offer different services. Some, for example, have extensive research departments and can provide current information and analysis concerning market developments as well as specific trading suggestions. Others tailor their services to clients who prefer to make market judgments and arrive at trading decisions on their own. Still others offer various combinations of these and other services. An individual trading account can be opened either directly with a Futures Commission Merchant or indirectly through an Introducing Broker. Whichever course you choose, the account itself will be carried by a Futures Commission Merchant, and your money held by that firm. Introducing Brokers cannot accept or handle customer funds, but most offer a variety of trading-related services. Futures Commission Merchants are required to maintain the funds and property of their customers in segregated accounts, separate from the firm's own money. Along with the particular services a firm provides, consider the commissions and trading costs that will be involved. And, as mentioned, clearly understand how the firm requires that any margin calls be met. If you have a question about whether a firm is properly registered with the CFTC and is a Member of NFA, you can (and should) contact NFA's Information Center toll-free at 800-621-3570 (within Illinois call 800-572-9400).

Have Someone Manage Your Account

A managed account is also your individual account. The major difference is that you give someone else--an account manager--written power of attorney to make and execute decisions about what and when to trade. He or she will have discretionary authority to buy or sell for your account but may contact you for approval to make trades he or she suggests. You, of course, remain fully responsible for any losses which may be incurred and, as necessary, for meeting margin calls, including making up any deficiencies that exceed your margin deposits. Although an account manager is likely to be managing the accounts of other persons at the same time, there is no sharing of gains or losses with other customers. Trading gains or losses in your account will result solely from trades which were made for your account. Many Futures Commission Merchants and Introducing Brokers accept managed accounts. In most instances, the amount of money needed to open a managed account is larger than the amount required to establish an account you intend to trade yourself. Different firms and account managers, however, have different requirements and the range can be quite wide. Be certain to read and understand all of the literature and agreements you receive from the broker. Some account managers have their own trading approaches and accept only clients to whom that approach is acceptable. Others tailor their trading to a client's objectives. In either case, obtain enough information and ask enough questions to assure yourself that your money will be managed in a way that's consistent with your goals. Discuss fees. In addition to commissions on trades made for your account, it is not uncommon for account managers to charge a management fee, and/or there may be some arrangement for the manager to participate in the net profits that his management produces. These charges are required to be fully disclosed in advance. Make sure you know about every charge to be made to your account and what each charge is for. While there can be no assurance that past performance will be indicative of future performance, it can be useful to inquire about the track record of an account manager you are considering. Account managers associated with a Futures Commission Merchant or Introducing Broker must generally meet certain experience requirements if the account is to be traded on a discretionary basis. Finally, take note of whether the account management agreement includes a provision to automatically liquidate positions and close out the account if and when losses exceed a certain amount. And, of course, you should know and agree on what will be done with profits, and what, if any, restrictions apply to withdrawals from the account.

Use a Commodity Trading Advisor

As the term implies, a Commodity Trading Advisor ("CTA") is an individual (or firm) that, for a fee, provides advice on commodity trading, including specific trading recommendations such as when to establish a particular long or short position and when to liquidate that position. Generally, to help you choose trading strategies that match your trading objectives, advisors offer analyses and judgments as to the prospective rewards and risks of the trades they suggest. Trading recommendations may be communicated by phone, wire or mail. Some offer the opportunity for you to phone when you have questions and some provide a frequently updated hotline you can call for a recording of current information and trading advice. Even though you may trade on the basis of an advisor's recommendations, you will still need to open your own account with, and send your margin payments directly to, a Futures Commission Merchant. Commodity Trading Advisors cannot accept or handle their customers funds unless they are also registered as Futures Commission Merchants. Some Commodity Trading Advisors offer managed accounts. The account itself, however, must still be with a Futures Commission Merchant and in your name, with the advisor designated in writing to make and execute trading decisions on a discretionary basis. CFTC Regulations require that Commodity Trading Advisors provide their customers, in advance, with what is called a Disclosure Document. Read it carefully and ask the Commodity Trading Advisor to explain any points you don't understand. If your money is important to you, so is the information contained in the Disclosure Document! The prospectus-like document contains information about the advisor, his experience and, by no means least, his current (and any previous) performance records. (Past performance is, however, not necessarily indicative of future results.) If you use an advisor to manage your account, he must first obtain a signed acknowledgment from you that you have received and understood the Disclosure Document. As in any method of participating in futures trading, discuss and understand the advisor's fee arrangements. And, if he will be managing your account, ask the same questions you would ask of any account manager you are considering. Commodity Trading Advisors must be registered as such with the CFTC, and those that accept authority to manage customer accounts must also be members of NFA. You can verify that these requirements have been met by calling NFA toll-free at 800-621-3570 (within Illinois call 800-572-9400).

Participate in Commodity Pool

Another alternative method of participating in futures trading is through a commodity pool, which is similar in concept to a common stock mutual fund. It is the only method of participation in which you will not have your own individual trading account. Instead, your money will be combined with that of other pool participants and, in effect, traded as a single account. You share in the profits or losses of the pool in proportion to your investment in the pool. One potential advantage is greater diversification of risks than you might obtain if you were to establish your own trading account. Another is that your risk of loss is generally limited to your investment in the pool, because most pools are formed as limited partnerships. And you won't be subject to margin calls. Bear in mind, however, that the risks which a pool incurs in any given futures transaction are no different than the risks incurred by an individual trader. The pool still trades in futures contracts which are highly leveraged and in markets which can be highly volatile. And like an individual trader, the pool can suffer substantial losses as well as realize substantial profits. A major consideration, therefore, is who will be managing the pool in terms of directing its trading. While a pool must execute all of its trades through a brokerage firm which is registered with the CFTC as a Futures Commission Merchant, it may or may not have any other affiliation with the brokerage firm. Some brokerage firms, to serve those customers who prefer to participate in commodity trading through a pool, either operate or have a relationship with one or more commodity trading pools. Other pools operate independently. A Commodity Pool Operator ("CPO", a registered entity which creates and/or manages pools) cannot accept your money until it has provided you with a Disclosure Document that contains information about the pool, the pool operator, the pool's principals and any outside persons who will be providing trading advice or making trading decisions. It must also disclose the previous performance records, if any, of all persons who will be operating or advising the pool or, if none, a statement to that effect). Commodity pool Disclosure Documents, like prospectuses, contain important information and should be carefully read before you invest your money. Another requirement is that the Disclosure Document advise you of the risks involved. In the case of a new pool, there is frequently a provision that the pool will not begin trading until (and unless) a certain amount of money is raised. Normally, a time deadline is set and the Commodity Pool Operator is required to state in the Disclosure Document what that deadline is (or, if there is none, that the time period for raising, funds is indefinite). Be sure you understand the terms, including how your money will be invested in the meantime, what interest you will earn (if any), and how and when your investment will be returned in the event the pool does not commence trading. Determine whether you will be responsible for any losses in excess of your investment in the pool. If so, this must be indicated prominently at the beginning of the pool's Disclosure Document. Ask about fees and other costs, including what, if any, initial charges will be made against your investment for organizational or administrative expenses. Such information should be noted in the Disclosure Document. You should also determine from the Disclosure Document how the pool's operator and advisor(s) are compensated, and the commissions to be paid to the Futures Commission Merchange carrying the pools' account. Understand, too, the procedure for redeeming your shares in the pool, any restrictions that may exist, and provisions for liquidating and dissolving the pool if more than a certain percentage of the capital were to be lost, Ask about the pool operator's general trading philosophy, what types of contracts will be traded, whether they will be day-traded, etc. With few exceptions, Commodity Pool Operators must be registered with the CFTC and be members of NFA. You can verify that these requirements have been met by contacting NFA toll-free at 800-621-3570 (within Illinois call 800-572-9400).

Regulation of Futures Trading

Firms and individuals that conduct futures trading business with the public are subject to regulation by the CFTC and by NFA. All futures exchanges are also regulated by the CFTC. NFA is a congressionally authorized self-regulatory organization subject to CFTC oversight. It exercises regulatory authority with the CFTC over Futures Commission Merchants, Introducing Brokers, Commodity Trading Advisors, Commodity Pool Operators and Associated Persons (salespersons) of all of the foregoing. The NFA staff consists of more than 140 field auditors and investigators. In addition, NFA has the responsibility for registering persons and firms that are required to be registered with the CFTC. Firms and individuals that violate NFA rules of professional ethics and conduct or that fail to comply with strictly enforced financial and recordkeeping requirements can, if circumstances warrant, be permanently barred from engaging in any futures-related business with the public. The enforcement powers of the CFTC are similar to those of other major federal regulatory agencies, including the power to seek criminal prosecution by the Department of Justice where circumstances warrant such action. Futures Commission Merchants which are members of an exchange are subject not only to CFTC and NFA regulation but also to regulation by all of the exchanges of which they are members. Exchange regulatory staffs are responsible, subject to CFTC oversight, for the business conduct and financial responsibility of their member firms. Violations of exchange rules can result in substantial fines, suspension or revocation of trading privileges, and loss of exchange membership.

Words of Caution

It is generally against the law for any person or firm to offer futures contracts for purchase or sale unless those contracts are traded on one of the nation's regulated futures exchanges and unless the person or firm is registered with the CFTC. Moreover, persons and firms conducting futures-related business with the public must be members of NFA. Thus, you should be extremely cautious if approached by someone attempting to sell you a commodity-related investment unless you are able to verify that the offeror is registered with the CFTC and is a member of NFA. In a number of cases, sellers of illegal off-exchange futures contracts have labeled their investments by different names--such as "deferred delivery," "forward" or "partial payment" contracts--in an attempt to avoid the strict laws applicable to regulated futures trading. Many operate out of telephone boiler rooms, employ high-pressure and misleading sales tactics, and may state that they are exempt from registration and regulatory requirements. This, in itself, should be reason enough to conduct a check before you write a check. You can quickly verify whether a particular firm or person is currently registered with the CFTC and is an NFA Member by phoning NFA toll-free at 800-621-3570 (within Illinois call 800-572-9400

Establishing an Account

At the time you apply to establish a futures trading account, you can expect to be asked for certain information beyond simply your name, address and phone number. The requested information will generally include (but not necessarily be limited to) your income, net worth, what previous investment or futures trading experience you have had, and any other information needed in order to advise you of the risks involved in trading futures contracts. At a minimum, the person or firm who will handle your account is required to provide you with risk disclosure documents or statements specified by the CFTC and to obtain written acknowledgment that you have received and understood them. Opening a futures account is a serious decision--no less so than making any major financial investment--and should obviously be approached as such. Just as you wouldn't consider buying a car or a house without carefully reading and understanding the terms of the contract, neither should you establish a trading account without first reading and understanding the Account Agreement and all other documents supplied by your broker. It is in your interest and the firm's interest that you clearly know your rights and obligations as well as the rights and obligations of the firm with which you are dealing before you enter into any futures transaction. If you have questions about exactly what any provisions of the Agreement mean, don't hesitate to ask. A good and continuing relationship can exist only if both parties have, from the outset, a clear understanding of the relationship. Nor should you hesitate to ask, in advance, what services you will be getting for the trading commissions the firm charges. As indicated earlier, not all firms offer identical services. And not all clients have identical needs. If it is important to you, for example, you might inquire about the firm's research capability, and what reports it makes available to clients. Other subjects of inquiry could be how transaction and statement information will be provided, and how your orders will be handled and executed.

What to Look for in a Futures Contract

Whatever type of investment you are considering--including but not limited to futures contracts-- it makes sense to begin by obtaining as much information as possible about that particular investment. The more you know in advance, the less likely there will be surprises later on. Moreover, even among futures contracts, there are important differences which--because they can affect your investment results--should be taken into account in making your investment decisions.

The Contract Unit

Delivery-type futures contracts stipulate the specifications of the commodity to be delivered (such as 5,000 bushels of grain, 40,000 pounds of livestock, or 100 troy ounces of gold). Foreign currency futures provide for delivery of a specified number of marks, francs, yen, pounds or pesos. U.S. Treasury obligation futures are in terms of instruments having a stated face value (such as $100,000 or $1 million) at maturity. Futures contracts that call for cash settlement rather than delivery are based on a given index number times a specified dollar multiple. This is the case, for example, with stock index futures. Whatever the yardstick, it's important to know precisely what it is you would be buying or selling, and the quantity you would be buying or selling.

How Prices are Quoted

Futures prices are usually quoted the same way prices are quoted in the cash market (where a cash market exists). That is, in dollars, cents, and sometimes fractions of a cent, per bushel, pound or ounce; also in dollars, cents and increments of a cent for foreign currencies; and in points and percentages of a point for financial instruments. Cash settlement contract prices are quoted in terms of an index number, usually stated to two decimal points. Be certain you understand the price quotation system for the particular futures contract you are considering.

Minimum Price Changes

Exchanges establish the minimum amount that the price of a futures contract can fluctuate upward or downward. This minimum is known as the "tick" For example, each tick for grain is 0.25 cents per bushel. On a 5,000 bushel futures contract, that's $12.50. On a gold futures contract, the tick is 10 cents per ounce, which on a 100 ounce contract is $10. You'll want to familiarize yourself with the minimum price fluctuation--the tick size--for whatever futures contracts you plan to trade. And, of course, you'll need to know how a price change of any given amount will affect the value of the contract.

Daily Price Limits

Exchanges also establish daily price limits for trading in futures contracts. The limits are stated in terms of the previous day's closing price plus and minus so many cents or dollars per trading unit. Once a futures price has increased by its daily limit, there can be no trading at any higher price until the next day of trading. Conversely, once a futures price has declined by its daily limit, there can be no trading at any lower price until the next day of trading. Thus, if the daily limit for a particular grain is currently 10 cents a bushel and the previous day's settlement price was $3.00, there can not be trading during the current day at any price below $2.90 or above $3.10. The price is allowed to increase or decrease by the limit amount each day. For some contracts, daily price limits are eliminated during the month in which the contract expires. Because prices can become particularly volatile during the expiration month (also called the "delivery" or "spot" month), persons lacking experience in futures trading may wish to liquidate their positions prior to that time. Or, at the very least, they should trade cautiously and with an understanding of the increased risks which may be involved. Daily price limits set by the exchanges are subject to change. They can, for example, be increased or removed entirely once the market price has increased or decreased by the existing limit for a given number of successive days. Because of daily price limits, there can be occasions when it is not possible to liquidate an existing futures position. In this event, possible alternative strategies should be discussed with a broker.

Position Limits

Although the average trader is unlikely to ever approach them, exchanges and the CFTC establish limits on the maximum speculative position that any one person can have at one time in any one futures contract. The purpose is to prevent one buyer or seller from being able to exert undue influence on the price in either the establishment or liquidation of positions. Position limits are stated in number of contracts or total units of the commodity. The easiest way to obtain the types of information just discussed is to ask your broker or other advisor to provide you with a copy of the contract specifications for the specific futures contracts you are thinking about trading. Or you can obtain the information from the exchange where the contract is traded.

Understanding (and Managing) the Risks of Futures Trading

Anyone buying or selling futures contracts should clearly understand that the risks of any given transaction may result in a futures trading loss. The loss may exceed not only the amount of the initial margin, but also the entire amount deposited in the account and more. Moreover, while there are a number of steps which can be taken in an effort to limit the size of possible losses, there can be no guarantees that these steps will prove effective. Well-informed futures traders should, nonetheless, be familiar with available risk management possibilities.

Choosing a Futures Contract

Just as different common stocks or different bonds may involve different degrees of risk and reward at a particular time, so may different futures contracts. The market for one commodity may, at present, be highly volatile, perhaps because of supply-demand uncertainties which-- depending on future developments-- could suddenly propel prices sharply higher or sharply lower. The market for some other commodity may currently be less volatile, with greater likelihood that prices will fluctuate in a narrower range. You should be able to evaluate and choose the futures contracts that appear--based on present information--most likely to meet your objectives and willingness to accept risk. Keep in mind, however, that neither past nor even present price behavior provides assurance of what will occur in the future. Prices that have been relatively stable may become highly volatile (which is why many individuals and firms choose to hedge against unforeseeable price changes).

Liquidity

There can be no assurance that, at all times, a liquid market will exist for offsetting a futures contract that you have previously bought or sold. This could be the case if, for example, a futures price has increased or decreased by the maximum allowable daily limit and there is no one presently willing to buy the futures contract you want to sell or sell the futures contract you want to buy. Even on a day-to-day basis, some contracts and some delivery months tend to be more actively traded and liquid than others. Two useful indicators of liquidity are the volume of trading and the open interest (the number of open futures positions still remaining to be liquidated by an offsetting trade or satisfied by delivery). These figures are usually reported in newspapers that carry futures quotations. The information is also available from your broker or advisor and from the exchange where the contract is traded.

Timing

In futures trading, being right about the direction of prices isn't enough. It is also necessary to anticipate the timing of price changes. The reason, of course, is that an adverse price change may, in the short run, result in a greater loss than you are willing to accept in the hope of eventually being proven right in the long run. Example: In January, you deposit initial margin of $1,500 to buy a May wheat futures contract at $3.30--anticipating that, by spring, the price will climb to $3.50 or higher. No sooner than you buy the contract, the price drops to $3.15, a loss of $750. To avoid the risk of a further loss, you have your broker liquidate the position. The possibility that the price may now recover--and even climb to $3.50 or above--is of no consolation. The lesson to be learned is that deciding when to buy or sell a futures contract can be as important as deciding what futures contract to buy or sell. In fact, it can be argued that timing is the key to successful futures trading.

Order Types

Day Orders/Open Orders (GTC)

All orders are either “day” or “open” (also called GTC — “good-’til-canceled”) orders. A day order automatically expires if it is not executed during the trading session it was entered. An open order will remain in effect until filled, canceled, or until the contract expires. Open or GTC orders should be marked as such. Some brokerage firms have pre-printed order forms which indicate either OPEN or GTC. Check with your firm regarding their policy on open or GTC orders.

Market Orders

A market order is to be filled at the best available price immediately upon receipt by the broker.

Limit Orders

A limit order is one that can be executed only at a specified price or better. For example, if a limit order reads to "buy 2 February Live Cattle at 65.17" it is understood that the order will be filled at 65.17 or any price lower than 65.17. It cannot be filled at any price higher than 65.17.

CXL Orders (Cancellation Orders)

An order to cancel (CXL) instructs the broker to remove a previously entered order from his deck. This may also be called a "straight cancel," which means the order being cancelled is not being replaced with another order. When a cancel order is delivered to the broker, both the cancel order and the order being cancelled must be returned to the order entry desk. To facilitate cancellation of an order, the cancel order will also state the order ticket number of the order being cancelled.

CFO Orders (Cancel Former Order)

A CFO order is an order entered to replace one already in the broker's deck. This one order does the work of two, and is an easy way of writing a new order while canceling an old order.

Stop Orders

A stop order is one that becomes a market order if and when the market reaches a designated price. A "buy stop" is placed above the market and becomes a market order when the commodity trades at or is bid at or above the specified stop price. A "sell stop" is placed at a price below the market. It becomes a market order when the commodity trades at or is offered at the stop price or below.

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MOC Orders (Market On Close)

An MOC order instructs the broker to fill the order at the market during the close, which is the last 30 seconds of trading (60 seconds in financials). The order must be filled at a price that falls within the closing range. In the example below, if the closing range was 8678 to 8682, the price at which the order was filled would have to be 8678, 8679, 8680, 8681 or 8682. Any other price would cause an error.

Stop Limit Orders

A stop limit order is a stop order which becomes a limit order if and when the market reaches a designated price. For example, the broker is instructed to buy 1 December S&P when the price of 757.50 is reached, but not at a price above 757.75.

Another type of a stop limit order can be seen in the example below. This order instructs the broker to sell 1 March S&P at 746.50 stop limit; the stop and limit being the same price. This means that the broker must sell the order at the stated price, or a higher price, once the stop limit price is reached. If it is not reached again, the order is reported "unable" (and then becomes a sell limit order).

Opening-Only Orders

An opening-only order may be a market, limit, stop or stop limit order that instructs the broker to fill the order during the opening. These orders must be filled at a price within the opening range of prices. An opening-only market order must be filled; however, any of the other types of opening-only orders may or may not be filled, depending on whether the broker was able to fill them.
The opening range for the following examples in March Canadian Dollars is .7340 to .7344. Can you tell which of the four opening-only orders should have been filled?

OCO Orders (One Cancels the Other or Order Cancels Order)

An OCO order involves the entry of two separate orders. If one order is filled, the other is automatically cancelled. The broker is given both orders so that each can be filed in the appropriate place in his deck. The member firm employee must be sure to get both orders back from the broker when one is filled, checking to be sure the other order has been cancelled and not filled in error. For example, you instruct the broker to buy 1 Feb Live Cattle at 65.17 or better. If this is not possible, then buy 1 at the market on the close. Whichever order is filled, the other is cancelled.

MIT Orders (Market-If-Touched)

An MIT order to buy becomes a market order if and when the commodity trades, or is offered, at a specified price or lower; an MIT order to sell becomes a market order if and when the commodity trades or is bid at a specified price or higher. An MIT order differs from a limit order in that the order becomes a market order once the MIT price is reached. The order must be filled, even if the market takes a turn in the opposite direction. In our example, the order reads to sell 7 June Deutsche marks 64.83 MIT. Let's say that a trade occurs at 64.83 then the next three trades are 64.82, 64.81, and 64.80. Our order is filled at 64.81. This would not be the case with a limit order to sell 7 June D-Marks 64.83. We would not necessarily have a fill at 64.83.

FOK Orders (Fill-Or-Kill)

A FOK order instructs the broker to make one attempt to bid or offer the order and, if not filled immediately, cancel the order. The customer placing the order may be on the telephone while this attempt is made, thereby making it necessary for the runner to wait for the broker to try to fill the order and then notify the phone clerk of its status. FOK orders are written very close to current trading levels and should be delivered to the broker **without delay**.

DRT Orders (Disregard Tape)

A DRT order is a discretionary order. These orders may also be referred to as "Market Not Held" orders. The filling broker treats a DRT as a special order, using his expertise to try to obtain the best possible fill. The broker can take his time in filling a discretionary order.

Wire Orders

A wire order is electronically transmitted to the trading floor from firm offices. The conventions for writing wire orders follow those of written orders.

The orders are printed on the trading floor by machines linked to the firm's order systems and are taken to the pits by runners. The orders may be printed on standard forms. Note that these types of orders show information in addition to market instructions. They will commonly have an order and account number on them, as well as internal information about the account.

Option on Futures Orders

An option on futures order is written in a format similar to that of a futures order, with the addition of the strike price and the put/call indicator. A sample order reads "For account 12345, buy 1 March Deutsche mark 670 call at .60.

Glossary

Accrued Interest – Interest earned between the most recent interest payment and the present date but not yet paid to the lender.

Actuals – An actual physical commodity someone is buying or selling, e.g., soybeans, corn, gold, silver, Treasury bonds, etc. Also referred to as actuals.

Add-on Method – A method of paying interest where the interest is added onto the principal at maturity or interest payment dates.

Adjusted Futures Price – The cash-price equivalent reflected in the current futures price. This is calculated by taking the futures price times the conversion factor for the particular financial instrument (e.g., bond or note) being delivered.

Against Actuals – A transaction generally used by two hedgers who want to exchange futures for cash positions. Also referred to as “against actuals” or “versus cash”.

Assign – To make an option seller perform his obligation to assume a short futures position (as a seller of a call option) or a long futures position (as a seller of a put option).

Associate Membership – A Chicago Board of Trade membership that allows an individual to trade financial instrument futures and other designated markets.

Associated Person (AP) – An individual who solicits orders, customers, or customer funds (or who supervises persons performing such duties) on behalf of a Futures Commission Merchant, an Introducing Broker, a Commodity Trading Adviser, or a Commodity Pool Operator.

At-the-Money Option – An option with a strike price that is equal, or approximately equal, to the current market price of the underlying futures contract.

Balance of Payment – A summary of the international transactions of a country over a period of time including commodity and service transactions, and gold movements.

Bar Chart – A chart that graphs the high, low, and settlement prices for a specific trading session over a given period of time.

Basis – The difference between the current cash price and the futures price of the same commodity. Unless otherwise specified, the price of the nearby futures contract month is generally used to calculate the basis.

Bear – Someone who thinks market prices will decline.

Bear Market – A period of declining market prices.

Bear Spread – In most commodities and financial instruments, the term refers to selling the nearby contract month, and buying the deferred contract, to profit from a change in the price relationship.

Bid – An expression indicating a desire to buy a commodity at a given price, opposite of offer.

Book Entry Securities – Electronically recorded securities that include each creditor's name, address, Social Security or tax identification number, and dollar amount loaned, (I.e., no certificates are issued to bond holders, instead the transfer agent electronically credits interest payments to each creditor's bank account on a designated date).

Broker – A company or individual that executes futures and options orders on behalf of financial and commercial institutions and/or the general public.

Brokerage Fee – A fee charged by a broker for executing a transaction.

Brokerage House – An individual or organization that solicits or accepts orders to buy or sell futures contracts or options on futures and accepts money or other assets from customers to support such orders. Also referred to as "commission house" or "wire house".

Bull – Someone who thinks market prices will rise.

Bull Market – A period of rising market prices.

Bull Spread – In most commodities and financial instruments, the term refers to buying the nearby month, and selling the deferred month, to profit from the change in the price relationship.

Butterfly Spread – The placing of two interdelivery spreads in opposite directions with the center delivery month common to both spreads.

Buying Hedge – Buyer futures contracts to protect against a possible price increase of cash commodities that will be purchased in the future. At the time the cash commodities are bought, the open futures position is closed by selling an equal number and type of futures contracts as those that were initially purchased.

COM Membership – A Chicago Board of Trade membership that allows an individual to trade contracts listed in the commodity options market category.

Calendar Spread – The purchase of one delivery month of a given futures contract and simultaneous sale of another delivery month of the same commodity on the same exchange. The purchase of either a call or put option and the simultaneous sale of the same type of option with typically the same strike price but with a different expiration month.

Call Option – An option that gives the buyer the right, but not the obligation, to purchase (go “long”) the underlying futures contract at the strike price on or before the expiration date.

Canceling Order – An order that deletes a customer’s previous order.

Carrying Charge – For physical commodities such as grains and metals, the cost of storage space, insurance, and finance charges incurred by holding a physical commodity. In interest rate futures markets, it refers to the differential between the yield on a cash instrument and the cost of funds necessary to buy the instrument. Also referred to as cost of carry or carry.

Carryover – Grain and oilseed commodities not consumed during the marketing year and remaining in storage at year’s end. These stocks are “carried over” into the next marketing year and added to the stocks produced during that crop year.

Cash Commodity – An actual physical commodity someone is buying or selling, e.g., soybeans, corn, gold, silver, Treasury bonds, etc. Also referred to as actuals.

Cash Contract – A sales agreement for either immediate or future delivery of the actual product.

Cash Market – A place where people buy and sell the actual commodities, i.e., grain elevator, bank, etc. Spot usually refers to a cash market price for a physical commodity that is available for immediate delivery. A forward contract is a cash contract in which a seller agrees to deliver a specific cash commodity to a buyer sometime in the future. Forward contracts, in contrast to futures contracts, are privately negotiated and are not standardized.

Certificate of Deposit (CD) – A time deposit with a specific maturity evidenced by a certificate.

Charting – The use of charts to analyze market behavior and anticipate future price movements. Those who use charting as a trading method plot such factors as high, low, and settlement prices; average price movements; volume; and open interest. Two basic price charts are bar charts and point-and-figure charts. Anticipating future price movement using historical prices, trading volume, open interest and other trading data to study price patterns.

Cheap – Colloquialism implying that a commodity is underpriced.

Cheapest to Deliver – A method to determine which particular cash debt instrument is most profitable to deliver against a futures contract.

Clear – The process by which a clearinghouse maintains records of all trades and settles margin flow on a daily mark-to-market basis for its clearing member.

Clearing Corporation – An independent corporation that settles all trades made at the Chicago Board of Trade acting as a guarantor for all trades cleared by it, reconciles all clearing member firm accounts each day to ensure that all gains have been credited and all losses have been collected, and sets and adjusts clearing member firm margins for changing market conditions.

Clearing Margin – Financial safeguards to ensure that clearing members (usually companies or corporations) perform on their customers' open futures and options contracts. Clearing margins are distinct from customer margins that individual buyers and sellers of futures and options contracts are required to deposit with brokers. See Customer Margin. Within the futures industry, financial guarantees required of both buyers and sellers of futures contracts and sellers of options contracts to ensure fulfilling of contract obligations. FCMs are responsible for overseeing customer margin accounts. Margins are determined on the basis of market risk and contract value. Also referred to as performance-bond margin.

Clearing Member – A member of an exchange clearinghouse. Memberships in clearing organizations are usually held by companies. Clearing members are responsible for the financial commitments of customers that clear through their firm.

Clearinghouse – An agency or separate corporation of a futures exchange that is responsible for settling trading accounts, clearing trades, collecting and maintaining margin monies, regulating delivery, and reporting trading data. Clearinghouses act as third parties to all futures and options contracts, acting as a buyer to every clearing member seller and a seller to every clearing member buyer.

Closing Price – The last price paid for a commodity on any trading day. The exchange clearinghouse determines a firm's net gains or losses, margin requirements, and the next day's price limits, based on each futures and options contract settlement price. If there is a closing range of prices, the settlement price is determined by averaging those prices. Also referred to as settle price.

Closing Range – A range of prices at which buy and sell transactions took place during the market close.

Commission Fee – A fee charged by a broker for executing a transaction. Also referred to as brokerage fee.

Commission House – An individual or organization that solicits or accepts orders to buy or sell futures contracts or options on futures and accepts money or other assets from customers to support such orders. Also referred to as "wire house".

Commodity – An article of commerce or a product that can be used for commerce. In a narrow sense, products traded on an authorized commodity exchange. The types of commodities include agricultural products, metals, petroleum, foreign currencies, and financial instruments and index, to name a few.

Commodity Credit Corp – A branch of the U.S. Department of Agriculture, established in 1933, that supervises the government's farm loan and subsidy programs.

Commodity Futures Trading Commission (CFTC) – A federal regulatory agency established under the Commodity Futures Trading Commission Act, as amended in 1974, that oversees futures trading in the United States. The commission is comprised of five commissioners, one of whom is designated as chairman, all appointed by the President subject to Senate confirmation, and is independent of all cabinet departments.

Commodity Pool – An enterprise in which funds contributed by a number of persons are combined for the purpose of trading futures contracts or commodity options.

Commodity Pool Operator – An individual or organization that operates or solicits funds for a commodity pool.

Commodity Trading Adviser – A person who, for compensation or profit, directly or indirectly advises others as to the value or the advisability of buying or selling futures contracts or commodity options. Advising indirectly includes exercising trading authority over a customer's account as well as providing recommendations through written publications or other media.

Computerized Trading Reconstruction System – A Chicago Board of Trade computerized surveillance program that pinpoints in any trade the traders, the contract, the quantity, the price, and time of execution to the nearest minute.

Concurrent Indicators – Market indicators showing the general direction of the economy and confirming or denying the trend implied by the leading indicators.

Consumer Price Index (CPI) – A major inflation measure computed by the U.S. Department of Commerce. It measures the change in prices of a fixed market basket of some 385 goods and services in the previous month.

Contract Grades – The standard grades of commodities or instruments listed in the rules of the exchanges that must be met when delivering cash commodities against futures contracts. Grades are often accompanied by a schedule of discounts and premiums allowable for delivery of commodities of lesser or greater quality than the standard called for by the exchange.

Contract Month – A specific month in which delivery may take place under the terms of a futures contract.

Controlled Account – An arrangement by which the holder of the account gives written power of attorney to another person, often his broker, to make trading decisions. Also known as a discretionary or managed account.

Convergence – A term referring to cash and futures prices tending to come together (i.e., the basis approaches zero) as the futures contract nears expiration.

Conversion Factor – A factor used to equate the price of T-bond and-note futures contracts with the various cash T_bonds and T-notes eligible for delivery. This factor is based on the relationship of the cash-instrument coupon to the required 6 percent deliverable grade of a futures contract as well as taking into account the cash instrument's maturity or call.

Cost of Carry (or Carry) – For physical commodities such as grains and metals, the cost of storage space, insurance, and finance charges incurred by holding a physical commodity. In interest rate futures markets, it refers to the differential between the yield on a cash instrument and the cost of funds necessary to buy the instrument.

Coupon – The interest rate on a debt instrument expressed in terms of a percent on an annualized basis that the issuer guarantees to pay the holder until maturity.

Crop (Marketing) Year – The time span from harvest to harvest for agricultural commodities. The crop marketing year varies slightly with each ag commodity, but it tends to begin at harvest and end before the next year's harvest, e.g., the marketing year for soybeans begins September 1 and ends August 31. The futures contract month of November represents the first major new-crop marketing month, and the contract month of July represents the last major old crop marketing month for soybeans.

Crop Reports – Reports compiled by the U.S. Department of Agriculture on various ag commodities that are released throughout the year. Information in the reports includes estimates on planted acreage, yield, and expected production, as well as comparison of production from previous years.

Cross-Hedging – Hedging a cash commodity using a different but related futures contract when there is no futures contract for the cash commodity being hedged and the cash and futures markets follow similar price trends (e.g., using soybean meal futures to hedge fish meal).

Crush Spread – The purchase of soybean futures and the simultaneous sale of soybean oil and meal futures.

Current Yield – The ratio of the coupon to the current market price of the debt instrument.

Customer Margin – Within the futures industry, financial guarantees required of both buyers and sellers of futures contracts and sellers of options contracts to ensure fulfilling of contract obligations. FCMs are responsible for overseeing customer margin accounts. Margins are determined on the basis of market risk and contract value. Also referred to as performance-bond margin. Financial safeguards to ensure that clearing members (usually companies or corporations) perform on their customers' open futures and options contracts. Clearing margins are distinct from customer margins that individual buyers and sellers of futures and options contracts are required to deposit with brokers.

Daily Trading Limit – The maximum price range set by the exchange cash day for a contract.

Day Traders – Speculators who take positions in futures or options contracts and liquidate them prior to the close of the same trading day.

Deferred (Delivery) Month – The more distant month(s) in which futures trading is taking place, as distinguished from the nearby (delivery) month.

Deliverable Grades – The standard grades of commodities or instruments listed in the rules of the exchanges that must be met when delivering cash commodities against futures contracts. Grades are often accompanied by a schedule of discounts and premiums allowable for delivery of commodities of lesser or greater quality than the standard called for by the exchange. Also referred to as contract grades.

Delivery – The transfer of the cash commodity from the seller of a futures contract to the buyer of a futures contract. Each futures exchange has specific procedures for delivery of a cash commodity. Some futures contracts, such as stock index contracts, are cash settled.

Delivery Day – The third day in the delivery process at the Chicago Board of Trade, when the buyer's clearing firm presents the delivery notice with a certified check for the amount due at the office of the seller's clearing firm.

Delivery Month – A specific month in which delivery may take place under the terms of a futures contract. Also referred to as contract month.

Delivery Points – The locations and facilities designated by a futures exchange where stocks of a commodity may be delivered in fulfillment of a futures contract, under procedures established by the exchange.

Delta – A measure of how much an option premium changes, given a unit change in the underlying futures price. Delta often is interpreted as the probability that the option will be in-the-money by expiration.

Demand, Law of – The relationship between product demand and price.

Differentials – Price differences between classes, grades, and delivery locations of various stocks of the same commodity.

Discount Method – A method of paying interest by issuing a security at less than par and repaying par value at maturity. The difference between the higher par value and the lower purchase price is the interest.

Discount Rate – The interest rate charged on loans by the Federal Reserve Bank.

Discretionary Account – An arrangement by which the holder of the account gives written power of attorney to another person, often his broker, to make trading decisions. Also known as a controlled or managed account.

Econometrics – The application of statistical and mathematical methods in the field of economics to test and quantify economic theories and the solutions to economic problems.

Equilibrium Price – The market price at which the quantity supplied of a commodity equals the quantity demanded.

Eurodollars – U.S. dollars on deposit with a bank outside of the United States and, consequently, outside the jurisdiction of the United States. The bank could be either a foreign bank or a subsidiary of a U.S. bank.

European Terms – A method of quoting exchange rates, which measures the amount of foreign currency needed to buy one U.S. dollar, i.e., foreign currency unit per dollar. Reciprocal of European Terms is another method of quoting exchange rates, which measures the U.S. dollar value of one foreign currency unit, i.e., U.S. dollars per foreign units.

Exchange for Physicals – A transaction generally used by two hedgers who want to exchange futures for cash positions. Also referred to as Against Actuals or Versus Cash.

Exercise – The action taken by the holder of a call option if he wishes to purchase the underlying futures contract or by the holder of a put option if he wishes to sell the underlying futures contract.

Exercise Price – The price at which the futures contract underlying a call or put option can be purchased (if a call) or sold (if a put). Also referred to as strike price.

Expanded Trading Hours – Additional trading hours of specific futures and options contracts at the Chicago Board of Trade that overlap with business hours in other time zones.

Expiration Date – Options on futures generally expire on a specific date during the month preceding the futures contract delivery month. For example, an option on a March futures contract expires in February but is referred to as a March option because its exercise would result in a March futures contract position.

Extrinsic Value – The amount of money option buyer are willing to pay for an option in the anticipation that, over time, a change in the underlying futures price will cause the option to increase in value. In general, an option premium is the sum of time value and intrinsic value. Any amount by which an option premium exceeds the option's intrinsic value can be considered time value. Also referred to as time value.

Face Value – The amount of money printed on the face of the certificate of a security; the original dollar amount of indebtedness incurred.

Federal Funds – Member bank deposits at the Federal Reserve; these funds are loaned by member banks to other member banks.

Federal Funds Rate – The rate of interest charged for the use of federal funds.

Federal Housing Administration (FHA) – A division of the U.S. Department of Housing and Urban Development that insures residential mortgage loans and sets construction standards.

Federal Reserve System – A central banking system in the United States, created by the Federal Reserve Act in 1913, designed to assist the nation in attaining its economic and financial goals. The structure of the Federal Reserve System includes a Board of Governors, the Federal Open Market Committee, and 12 Federal Reserve Banks.

Feed Ratio – A ratio used to express the relationship of feeding costs to the dollar value of livestock.

> Hog/Corn Ratio The relationship of feeding costs to the dollar value of hogs. It is measured by dividing the price of hogs $/hundredweight) by the price of corn ($/bushel). When corn prices are high relative to pork prices, fewer units of corn equal the dollar value of 100 pounds of pork. Conversely, when corn prices are low in relation to pork prices, more units of corn are required to equal the value of 100 pounds of pork.
>
> Steer/Corn Ratio. The relationship of cattle prices to feeding costs. It is measured by dividing the price of cattle ($/hundredweight) by the price of corn ($/bushel). When corn prices are high relative to cattle prices, fewer units of corn equal the dollar value of 100 pounds of cattle. Conversely, when corn prices are low in relation to cattle prices, more units of corn are required to equal the value of 100 pounds of beef.

Fill-or Kill – A customer order that is a price limit order that must be filled immediately or canceled.

Financial Analysis Auditing Compliance Tracking System (FACTS) – The National Futures Association's computerized system of maintaining financial records of its member firms and monitoring their financial conditions.

Financial Instrument – There are two basic types: (1) a debt instrument, which is a loan with an agreement to pay back funds with interest; (2) an equity security, which is share or stock in a company.

First Notice Day – According to Chicago Board of Trade rules, the first day on which a notice of intent to deliver a commodity in fulfillment of a given month's futures contract can be made by the clearinghouse to a buyer. The clearinghouse also informs the sellers who they have been matched up with.

Floor Broker (FB) – An individual who executes orders for the purchase or sale of any commodity futures or options contract on any contract market for any other person.

Floor Trader (FT) – An individual who executes trades for the purchase or sale of any commodity futures or options contract on any contract market for such individual's own account.

Foreign Exchange Market – An over-the-counter market where buyers and sellers conduct foreign exchange business by telephone and other means of communication. Also referred to as a forex market.

Forex Market – An over-the-counter market where buyers and sellers conduct foreign exchange business by telephone and other means of communication. Also referred to as foreign exchange market.

Forward (Cash) Contract – A cash contract in which a seller agrees to deliver a specific cash commodity to a buyer sometime in the future. Forward contracts, in contrast to futures contracts, are privately negotiated and are not standardized.

Full Carrying Charge Market – A futures market where the price difference between delivery months reflects the total costs of interest, insurance, and storage

Full Membership (CBOT) – A Chicago Board of Trade membership that allows an individual to trade all futures and options contracts listed by the exchange.

Fundamental Analysis – A method of anticipating future price movement using supply and demand information.

Futures Commission Merchant (FCM) – An individual or organization that solicits or accepts orders to buy or sell futures contracts or options on futures and accepts money or other assets from customers to support such orders. Also referred to as "commission house" or "wire house".

Futures Contract –A legally binding agreement, made on the trading floor of a futures exchange, to buy or sell a commodity or financial instrument sometime in the future. Futures contracts are standardized according to the quality, quantity, and delivery time and location for each commodity. The only variable is price, which is discovered on an exchange trading floor.

Futures Exchange – A central marketplace with established rules and regulations where buyers and sellers meet to trade futures and options on futures contracts.

GIM Membership (CBOT) – A Chicago Board of Trade membership that allows an individual to trade all futures contracts listed in the government instrument market category.

GLOBEX – A global after-hours electronic trading system.

Gamma – A measurement of how fast delta changes, given a unit change in the underlying futures price.

Give-up – A transaction in which one clearing firm places and order for execution on behalf of a different clearing firm which ultimately will carry the trade.

Grain Terminal – Large grain elevator facility with the capacity to ship grain by rail and/or barge to domestic or foreign markets.

Gross Domestic Product – The value of all final goods and services produced by an economy over a particular time period, normally a year.

Gross National Product –
Gross Domestic Product plus the income accruing to domestic residents as a result of investments abroad less income earned in domestic markets accruing to foreigners abroad.

Gross Processing Margin – The difference between the cost of soybeans and the combined sales income of the processed soybean oil and meal.

Hedger – An individual or company owning or planning to own a cash commodity, corn, soybeans, wheat, U.S. Treasury bonds, notes, bills etc. and concerned that the cost of the commodity may change before either buying or selling it in the cash market. A hedger achieves protection against changing cash prices by purchasing (selling)futures contracts of the same or similar commodity and later offsetting that position by selling (purchasing) futures contracts of the same quantity and type as the initial transaction.

Hedging – The practice of offsetting the price risk inherent in any cash market position by taking an equal but opposite position in the futures market. Hedgers use the futures markets to protect their business from adverse price changes. Selling (Short) Hedge – Selling futures contracts to protect against possible declining prices of commodities that will be sold in the future. At the time the cash commodities are sold, the open futures position is closed by purchasing an equal number and type of futures contracts as those that were initially sold. And Purchasing (Long) Hedge – Buyer futures contracts to protect against a possible price increase of cash commodities that will e purchased in the future. At the time the cash commodities are bought, the open futures position is closed by selling an equal number and type of futures contracts as those that were initially purchased. Also referred to as a buying hedge.

High – The highest price of the day for a particular futures contract.

Hog/Corn Ratio – The relationship of feeding costs to the dollar value of hogs. It is measured by dividing the price of hogs ($/hundredweight) by the price of corn ($/bushel). When corn prices are high relative to pork prices, fewer units of corn equal the dollar value of 100 pounds of pork. Conversely, when corn prices are low in relation to pork prices, more units of corn are required to equal the value of 100 pounds of pork. A ratio used to express the relationship of feeding costs to the dollar value of livestock.

Holder – The purchaser of either a call or put option. Option buyers receive the right, but not the obligation, to assume a futures position. Also referred to as the Option Buyer.

Horizontal Spread – The purchase of either a call or put option and the simultaneous sale of the same type of option with typically the same strike price but with a different expiration month. Also referred to as a calendar spread.

IDEM Membership (CBOT) – A Chicago Board of Trade membership of trading privileges for futures contract in the index, debt, and energy markets category (gold, municipal bond index, 30-day fed funds, and stock index futures).

In-the-Money Option – An option having intrinsic value. A call option is in-the-money if its strike price is below the current price of the underlying futures contract. A put option is in-the-money if its strike price is above the current price of the underlying futures contract. The amount by which an option is in-the-money.

Initial Margin – The amount a futures market participant must deposit into his margin account at the time he places an order to buy or sell a futures contract. Also referred to as original margin.

Intercommodity Spread – The purchase of a given delivery month of one futures market and the simultaneous sale of the same delivery month of a different, but related, futures market.

Interdelivery Spread – The purchase of one delivery month of a given futures contract and simultaneous sale of another delivery month of the same commodity on the same exchange. Also referred to as an intramarket or calendar spread.

Intermarket Spread – The sale of a given delivery month of a futures contract on one exchange and the simultaneous purchase of the same delivery month and futures contract on another exchange.

Intrinsic Value – The amount by which an option is in-the-money. An option having intrinsic value. A call option is in-the-money if its strike price is below the current price of the underlying futures contract. A put option is in-the-money if its strike price is above the current price of the underlying futures contract.

Introducing Broker – A person or organization that solicits or accepts orders to buy or sell futures contracts or commodity options but does not accept money or other assets from customers to support such orders.

Inverted Market – A futures market in which the relationship between two delivery months of the same commodity is abnormal.

Invisible Supply – Uncounted stocks of a commodity in the hands of wholesalers, manufacturers, and producers that cannot be identified accurately; stocks outside commercial channels but theoretically available to the market.

Lagging Indicators – Market indicators showing the general direction of the economy and confirming or denying the trend implied by the leading indicators. Also referred to as concurrent indicators.

Last Trading Day – According to the Chicago Board of Trade rules, the final day when trading may occur in a given futures or option contract month. Futures contracts outstanding at the end of the last trading day must be settled by delivery of the underlying commodity or securities or by agreement for monetary settlement (in some cases by EFPs)

Leading Indicators – Market indicators that signal the state of the economy for the coming months. Some of the leading indicators include: average manufacturing workweek, initial claims for unemployment insurance, orders for consumer goods and material, percentage of companies reporting slower deliveries, change in manufacturers' unfilled orders for durable goods, plant and equipment orders, new building permits, index of consumer expectations, change in material prices, prices of stocks, change in money supply.

Leverage – The ability to control large dollar amounts of a commodity with a comparatively small amount of capital.

Limit Order – An order in which the customer sets a limit on the price and/or time of execution.

Limits – The maximum number of speculative futures contracts one can hold as determined by the Commodity Futures Trading Commission and/or the exchange upon which the contract is traded. Also referred to as trading limit. The maximum advance or decline from the previous day's settlement permitted for a contract in one trading session by the rules of the exchange. According to the Chicago Board of Trade rules, an expanded allowable price range set during volatile markets.

Linkage – The ability to buy (sell) contracts on one exchange (such as the Chicago Mercantile Exchange) and later sell (buy) them on another exchange (such as the Singapore International Monetary Exchange.)

Liquid – A characteristic of a security or commodity market with enough units outstanding to allow large transactions without a substantial change in price. Institutional investors are inclined to seek out liquid investments so that their trading activity will not influence the market price.

Liquidate – Selling (or purchasing) futures contracts of the same delivery month purchased (or sold) during an earlier transaction or making (or taking) delivery of the cash commodity represented by the futures contract. Taking a second futures or options position opposite to the initial or opening position.

Liquidity Data Bank – A computerized profile of CBOT market activity, used by technical traders to analyze price trends and develop trading strategies. There is a specialized display of daily volume data and time distribution of prices for every commodity traded on the Chicago Board of Trade.

Loan Program – A federal program in which the government lends money at preannounced rates to farmers and allows them to use the crops they plant for the upcoming crop year as collateral. Default on these loans is the primary method by which the government acquires stock of agricultural commodities.

Loan Rate – The amount lent per unit of a commodity to farmers.

Long – One who has bought futures contracts or owns a cash commodity.

Long Hedge – Buyer futures contracts to protect against a possible price increase of cash commodities that will e purchased in the future. At the time the cash commodities are bought, the open futures position is closed by selling an equal number and type of futures contracts as those that were initially purchased. Also referred to as a buying hedge.

Low – The lowest price of the day for a particular futures contract.

Maintenance – A set minimum margin (per outstanding futures contract) that a customer must maintain in his margin account.

Managed Account – Financial safeguards to ensure that clearing members (usually companies or corporations) perform on their customers' open futures and options contracts. Clearing margins are distinct from customer margins that individual buyers and sellers of futures and options contracts are required to deposit with brokers. Within the futures industry, financial guarantees required of both buyers and sellers of futures contracts and sellers of options contracts to ensure fulfilling of contract obligations. FCMs are responsible for overseeing customer margin accounts. Margins are determined on the basis of market risk and contract value. Also referred to as performance-bond margin.

Managed Futures – Represents an industry comprised of professional money mangers known as commodity trading advisors who manage client assets on a discretionary basis, using global futures markets as an investment medium.

Margin – Financial safeguards to ensure that clearing members (usually companies or corporations) perform on their customers' open futures and options contracts. Clearing margins are distinct from customer margins that individual buyers and sellers of futures and options contracts are required to deposit with brokers. Within the futures industry, financial guarantees required of both buyers and sellers of futures contracts and sellers of options contracts to ensure fulfilling of contract obligations. FCMs are responsible for overseeing customer margin accounts. Margins are determined on the basis of market risk and contract value. Also referred to as performance-bond margin.

Margin Call – A call from a clearinghouse to a clearing member, or from a brokerage firm to a customer, to bring margin deposits up to a required minimum level.

Market Information Data Inquiry System (MIDIS) – Historical Chicago Board of Trade price, volume, open interest data and other market information accessible by computers within the Chicago Board of Trade building.

Market Order – An order to buy or sell a futures contract of a given delivery month to be filled at the best possible price and as soon as possible.

Market Price Reporting and Information Systems – The Chicago Board of Trade's computerized price-reporting system.

Market Profile – A Chicago Board of Trade information service that helps technical traders analyze price trends. Market Profile consists of the Time and Sales ticker and the Liquidity Data Bank

Market Reporter – A person employed by the exchange and located in or near the trading pit who records prices as they occur during trading.

Marking-to-Market – To debit or credit on a daily basis a margin account based on the close of that day's trading session. In this way, buyers an sellers are protected against the possibility of contract default.

Minimum Price Fluctuation – The smallest allowable increment of price movement for a contract.

Money Supply – The amount of money in the economy, consisting primarily of currency in circulation plus deposits in banks: M-1 U.S. money supply consisting of currency held by the public, traveler's checks, checking account funds, NOW and super- NOW accounts, automatic transfer service accounts, and balances in credit unions. M-2 U.S. money supply consisting M-1 plus savings and small time deposits (less than $100,000) at depository institutions, overnight repurchase agreements at commercial banks, and money market mutual fund accounts. M-3 U.S. money supply consisting of M-2 plus large time deposits ($100,000 or more) at depository institutions, repurchase agreements with maturities longer than one day at commercial banks, and institutional money market accounts.

Moving-Average Charts – A statistical price analysis method of recognizing different price trends. A moving average is calculated by adding the prices for a predetermined number of days and then dividing by the number of days.

Municipal Bonds – Debt securities issued by state and local governments, and special districts and counties.

National Futures Association (NFA) – An industry wide, industry-supported, self-regulatory organization for futures and options markets. The primary responsibilities of the NFA are to enforce ethical standards and customer protection riles, screen futures professional for membership, audit and monitor professionals for financial and general compliance rules and provide for arbitration of futures-related disputes.

Nearby (Delivery) Month – The futures contract month closest to expiration. Also referred to as spot month.

Negative Yield Curve – A chart in which the yield level is plot on the vertical axis and the term to maturity of debt instruments of similar creditworthiness is plotted n the horizontal axis. The yield curve is positive when long-term rates are higher than short-term rates However, yield curve is negative or inverted.

Notice Day – According to Chicago Board of Trade rules, the second day of the three-day delivery process when the clearing corporation matches the buyer with the oldest reported long position to the delivering seller and notifies both parties. See First Notice Day.

OPEC – Organization of Petroleum Exporting Countries, emerged as the major petroleum pricing power in 1973, when the ownership of oil production in the Middle East transferred from the operating companies to the governments of the producing countries or to their national oil companies. Members are: Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates and Venezuela.

Offer – An expression indicating one's desire to sell a commodity at a given price; opposite of bid.

Offset – Taking a second futures or options position opposite to the initial or opening position. Selling (or purchasing) futures contracts of the same delivery month purchased (or sold) during an earlier transaction or making (or taking) delivery of the cash commodity represented by the futures contract.

Open Interest – The total number of futures or options contracts of a given commodity that have not yet been offset by an opposite futures or option transaction nor fulfilled by delivery of the commodity or option exercise. Each open transaction has a buyer and a seller, but for calculation of open interest, only one side of the contract is counted.

Open Market Operation – The buying and selling of government securities Treasury bills, notes, and bonds by the Federal Reserve.

Open Outcry – Method of public auction for making verbal bids and offers in the trading pits or rings of futures exchanges.

Opening Range – A range of prices at which buy an sell transactions took place during the opening of the market.

Option – A contract that conveys the right, but not the obligation, to buy or sell a particular item at a certain price for a limited time. Only the seller of the option is obligated to perform.

Option Buyer – The purchaser of either a call or put option. Option buyers receive the right, but not the obligation, to assume a futures position. Also referred to as the holder.

Option Premium – The price of an option the sum of money that the option buyer pays and the option seller receives for the rights granted by the option.

Option Seller – The person who sells an option in return for a premium and is obligated to perform when the holder exercises his right under the option contract. Also referred to as the writer.

Option Spread – The simultaneous purchase and sale of one or more options contracts, futures, and/or cash positions.

Option Writer – The person who sells an option in return for a premium and is obligated to perform when the holder exercises his right under the option contract. Also referred to as the Option Seller.

Original Margin – The amount a futures market participant must deposit into his margin account at the time he places an order to buy or sell a futures contract. Also referred to as initial margin.

Out-of-the-Money Option – An option with no intrinsic value, i.e., a call whose strike price is above the current futures price or a put whose strike price is below the current futures price.

Over-the-Counter Market – A market where products such as stocks, foreign currencies, and other cash items are bought and sold by telephone and other means of communications.

Par – The face value of a security. For example, a bond selling at par is worth the same dollar amount it was issued for or at which it will be redeemed at maturity.

Payment-In-Kind Program – A government program in which farmers who comply with a voluntary acreage-control program and set aside an additional percentage of acreage specified by the government receive certificates that can be redeemed for government-owned stocks of grain.

Performance Bond Margin – The amount of money deposited by both buyer and seller of a futures contract or an options seller to ensure performance of the term of the contract. Margin in commodities is not a payment of equity or down payment on the commodity itself, but rather it is a security deposit. Within the futures industry, financial guarantees required of both buyers and sellers of futures contracts and sellers of options contracts to ensure fulfilling of contract obligations. FCMs are responsible for overseeing customer margin accounts. Margins are determined on the basis of market risk and contract value. Financial safeguards to ensure that clearing members (usually companies or corporations) perform on their customers' open futures and options contracts. Clearing margins are distinct from customer margins that individual buyers and sellers of futures and options contracts are required to deposit with brokers.

Pit – The area on the trading floor where futures and options on futures contracts are bought and sold. Pits are usually raised octagonal platforms with steps descending on the inside that permit buyers and sellers of contracts to see each other.

Point-and-Figure Charts – Charts that show price changes of a minimum amount regardless of the time period involved.

Position – A market commitment. A buyer of a futures contract is said to have a long position and, conversely, a seller of futures contracts is said to have a short position.

Position Day – According to the Chicago Board of Trade rules, the first day in the
process of making or taking delivery of the actual commodity on a futures contract. The clearing firm representing the seller notifies the Chicago Board of Trade Clearing Service Provider that its short customers want to deliver on a futures contract.

Position Limit – The maximum number of speculative futures contracts one can hold as determined by the Commodity Futures Trading Commission and/or the exchange upon which the contract is traded. Also referred to as trading limit.

Position Trader – An approach to trading in which the trader either buys or sells contracts and holds them for an extended period of time.

Premium – (1) The additional payment allowed by exchange regulation for delivery of higher-than required standards or grades of a commodity against a futures contract. (2) In speaking of price relationships between different delivery months of a given commodity, one is said to be “trading at a premium” over another when its price is greater than that of the other. (3) In financial instruments, the dollar amount by which a security trades above its principal value. The price of an option the sum of money that the option buyer pays and the option seller receives for the rights granted by the option.

Price Discovery – The generation of information about “future” cash market prices through the futures markets.

Price Limit – The maximum advance or decline from the previous day’s settlement permitted for a contract in one trading session by the rules of the exchange. According to the Chicago Board of Trade rules, an expanded allowable price range set during volatile markets.

Price Limit Order – A customer order that specifies the price at which a trade can be executed.

Primary Dealer – A designation given by the Federal Reserve System to commercial banks or broker/dealers who meet specific criteria. Among the criteria are capital requirements and meaningful participation in the Treasury auctions.

Primary Market – Market of new issues of securities.

Prime Rate – Interest rate charged by major banks to their most creditworthy customers.

Producer Price Index (PPI) – An index that shows the cost of resources needed to produce manufactured goods during the previous month.

Pulpit – A raised structure adjacent to, or in the center of, the pit or ring at a futures exchange where market reporters, employed by the exchange, record price changes as they occur in the trading pit.

Purchase and Sell Statement – A Statement sent by a commission house to a customer when his futures or options on futures position ha changed, showing the number of contracts bought or sold, the prices at which the contracts were bought or sold, the gross profit or loss, the commission charges, and the net profit or loss on the transaction.

Purchasing Hedge or Long Hedge – Buyer futures contracts to protect against a possible price increase of cash commodities that will e purchased in the future. At the time the cash commodities are bought, the open futures position is closed by selling an equal number and type of futures contracts as those that were initially purchased. Also referred to as a buying hedge. The practice of offsetting the price risk inherent in any cash market position by taking an equal but opposite position in the futures market. Hedgers use the futures markets to protect their business from adverse price changes.

Put Option – An option that gives the option buyer the right but not the obligation to sell (go "short") the underlying futures contract at the strike price on or before the expiration date.

Range (Price) – The price span during a given trading session, week, month, year, etc.

Reciprocal of European Terms – One method of quoting exchange rates, which measured the U.S. dollar value of one foreign currency unit, i.e., U.S. dollars per foreign units. See European Terms.
Repurchase Agreements or (Repo) – An agreement between a seller and a buyer, usually in U.S. government securities, in which the seller agrees to buy back the security at a later date.

Reserve Requirements – The minimum amount of cash and liquid assets as a percentage of demand deposits and time deposits that member banks of the Federal Reserve are required to maintain.

Resistance – A level above which prices have had difficulty penetrating.

Resumption – The reopening the following day of specific futures and options markets that also trade during the evening session at the Chicago Board of Trade.

Reverse Crush Spread – The sale of soybean futures and the simultaneous purchase of soybean oil and meal futures.

Runners – Messengers who rush orders received by phone clerks to brokers for execution in the pit.

Scalper – A trader who trades for small, short-term profits during the course of a trading session, rarely carrying a position overnight.

Secondary Market – Market where previously issued securities are bought and sold.

Security – Common or preferred stock; a bond of a corporation, government, or quasi- government body.

Selling Hedge or Short Hedge – Selling futures contracts to protect against possible declining prices of commodities that will be sold in the future. At the time the cash commodities are sold, the open futures position is closed by purchasing an equal number and type of futures contracts as those that were initially sold. The practice of offsetting the price risk inherent in any cash market position by taking an equal but opposite position in the futures market. Hedgers use the futures markets to protect their business from adverse price changes.

Short (noun) – One who has sold futures contracts or plans to purchase a cash commodity. (verb) Selling futures contracts or initiating a cash forward contract sale without offsetting a particular market position.

Short Hedge – Selling futures contracts to protect against possible declining prices of commodities that will be sold in the future. At the time the cash commodities are sold, the open futures position is closed by purchasing an equal number and type of futures contracts as those that were initially sold.

Simulation Analysis of Financial Exposure – A sophisticated computer risk-analysis program that monitors the risk of clearing member and large-volume traders at the Chicago Board of Trade. It calculates the risk of change in market prices or volatility to a firm carrying open positions.

Speculator – A market participant who tries to profit from buying and selling futures and options contracts by anticipating future price movements.

Speculators assume market price risk and add liquidity and capital to the futures markets.

Spot – Usually refers to a cash market price for a physical commodity that is available for immediate delivery.

Spot Month – The futures contract month closest to expiration. Also referred to as nearby delivery month.

Spread – The price difference between two related markets or commodities.

Spreading – The simultaneous buying and selling of two related markets in the expectation that a profit will be made when the position is offset. Examples include: buying one futures contract and selling another futures contract of the same commodity but different delivery month; buying and selling the same delivery month of the same commodity on different futures exchanges; buying a given delivery month of one futures market and selling the same delivery month of a different, but related, futures market.

Steer/Corn Ratio – The relationship of cattle prices to feeding costs. It is measured by dividing the price of cattle ($/hundredweight) by the price of corn ($/bushel). When corn prices are high relative to cattle prices, fewer units of corn equal the dollar value of 100 pounds of cattle. Conversely, when corn prices are low in relation to cattle prices, more units of corn are required to equal the value of 100 pounds of beef. A ratio used to express the relationship of feeding costs to the dollar value of livestock.

Stock Index – An indicator used to measure and report value changes in a selected group of stocks. How a particular stock index tracks the market depends on its composition the sampling of stocks, the weighing of individual stocks, and the method of averaging used to establish an index.

Stock Market – A market in which shares of stock are bought and sold.

Stop Order – An order to buy or sell when the market reaches a specified point. A stop order to buy becomes a market order when the futures contract trades (or is bid) at or above the stop price. A stop order to sell becomes a market order when the futures contract trades (or is offered) at or below the stop price.

Stop-Limit Order – A variation of a stop order in which a trade must be executed at the exact price or better. If the order cannot be executed, it is held until the stated price or better is reached again.

Strike Price – The price at which the futures contract underlying a call or put option can be purchased (if a call) or sold (if a put). Also referred to as exercise price.

Supply, Law of – The relationship between product supply and its price.

Support – The place on a chart where the buying of futures contracts is sufficient to halt a price decline.

Suspension – The end of the evening session for specific futures and options markets traded at the Chicago Board of Trade.

Technical Analysis – Anticipating future price movement using historical prices, trading volume, open interest and other trading data to study price patterns.

Tick – The smallest allowable increment of price movement for a contract.

Time Limit Order – A customer order that designates the time during which it can be executed.

Time Value – The amount of money option buyer are willing to pay for an option in the anticipation that, over time, a change in the underlying futures price will cause the option to increase in value. In general, an option premium is the sum of time value and intrinsic value. Any amount by which an option premium exceeds the option's intrinsic value can be considered time value. Also referred to as extrinsic value.

Time and Sales Ticker – Part of the Chicago Board of Trade Market Profile. System consisting of an on-line graphic service that transmits price and time information throughout the day.

Time-Stamped – Part of the order-routing process in which the time of day is stamped on an order. An order is time-stamped when it is (1) received on the trading floor, and (2) completed.

Trade Balance – The difference between a nation's imports and exports of merchandise.

Trading Limit – The maximum number of speculative futures contracts one can hold as determined by the Commodity Futures Trading Commission and/or the exchange upon which the contract is traded. Also referred to as position limit.

Treasury Bill – A Treasury bill is a short-term U.S. government obligation with an original maturity of one year or less. Unlike a bond or note, a bill does not pay a semi-annual, fixed rate coupon. A bill is typically issued at a price below its par value and is therefore a discounted instrument. The level of the discount depends on the level of prevailing interest rates. In general, the higher short-term interest rates are, the greater the discount. The return to an investor in bills is simply the difference between the issue price and par value.

Treasury Bond – Government-debt security with a coupon and original maturity of more than 10 years. Interest is paid semiannually.

Treasury Note – Government-debt security with a coupon and original maturity of one to 10 years.

U.S. Treasury Bill – A short-term U.S. government debt instrument with an original maturity of one year or less. Bills are sold at a discount from par with the interest earned being the difference between the face value received at maturity and the price paid.

U.S. Treasury Bond – Government-debt security with a coupon and original maturity of more than 10 years. Interest is paid semiannually.

U.S. Treasury Note – Government-debt security with a coupon and original maturity of one to 10 years.

Underlying Futures Contract – The specific futures contract that is bought or sold by exercising an option.

Variable Limit – According to the Chicago Board of Trade rules, an expanded allowable price range set during volatile markets.

Variation Margin – During periods of great market volatility or in the case of high-risk accounts, additional margin deposited by a clearing member firm to an exchange.

Versus Cash – A transaction generally used by two hedgers who want to exchange futures for cash positions. Also referred to as “against actuals” or “exchange for physicals.”

Vertical Spread – Buying and selling puts or calls of the same expiration month but different strike prices.

Volatility – A measurement of the change in price over a given period. It is often expressed as a percentage and computed as the annualized standard deviation of the percentage change in daily price.

Volume – The number of purchases or sales of a commodity futures contract made during a specific period of time, often the total transactions for one trading day.

Warehouse Receipt – Document guaranteeing the existence and availability of a given quantity and quality of a commodity in storage; commonly used as the instrument of transfer of ownership in both cash and futures transactions.

Wire House – An individual or organization that solicits or accepts orders to buy or sell futures contracts or options on futures and accepts money or other assets from customers to support such orders. Also referred to as “commission house” or Futures Commission Merchant (FCM).

Writer – The person who sells an option in return for a premium and is obligated to perform when the holder exercises his right under the option contract. Also referred to as the option seller.

Yield – A measure of the annual return on an investment.

Yield Curve – A chart in which the yield level is plot on the vertical axis and the term to maturity of debt instruments of similar creditworthiness is plotted n the horizontal axis. The yield curve is positive when long-term rates are higher than short-term rates; however, the yield curve is negative, or inverted, when long term rates are lower than short term rates.

Yield to Maturity – The rate of return an investor receives if a fixed-income security is held to maturity.