



The Basics: Futures and Options

WWW.MIDWESTFUTURES.COM
WWW.CTAFINDER.COM

1203 South 8th St.
P.O. Box 1097
Norfolk, NE 68701

Toll Free: (800) 672-8303
Fax: (402) 371-1999

Contents

<u>Intro to Futures and Options:</u>	Pg. 3
What They Are	
Futures Contracts	Pg. 4
Options on Futures Contracts	Pg. 4
The Futures Contract – What is already determined? - <i>Ex: Random Length Lumber</i>	Pg. 4 - 5
Options on Futures - <i>What does an option on a futures contract specify?</i>	Pg. 5
The Futures Exchange	Pg. 6
The Clearing Function	Pg. 6
Terms to Know	
Contract Settlement	Pg. 7
Market Participants - <i>Hedgers and Speculators</i>	Pg. 7
What is Margin?	Pg. 8
More on Options - <i>Puts and Calls</i>	Pg. 8 - 9
Open Outcry	Pg. 9
How to Read Prices	Pg. 10
Strategies	
The Trading Plan	Pg. 10
Short and Long Positioning	Pg. 11
Money Management	Pg. 11
The Leverage of Futures Markets	Pg. 11 - 12
Is Futures Trading for You?	Pg. 12
<u>Trading 101:</u>	Pg. 13
Getting Started	
How to Start Trading	Pg. 14
Tracking Your Trades	Pg. 14
Trading Styles - <i>Fundamental and Technical</i>	Pg. 15
The Trading Process	Pg. 15 - 16
Executing an Order	Pg. 16
Concepts to Know	
Floor Broker Responsibilities	Pg. 16
Price Limits	Pg. 16
Contracts Traded	Pg. 17
Regulation Authorities	Pg. 17
Supply and Demand	Pg. 18 - 19
Fundamental Analysis	
Agricultural Analysis	Pg. 19
Financial Analysis	Pg. 19
Technical Analysis	Pg. 20
What patterns does a chartist look for?	Pg. 20
Glossary	Pg. 21 - 29
Risk Disclosure	Pg. 30

Intro to

Futures and Options

Futures Contracts

A futures contract is an obligation to buy or sell a specific quantity and quality of a commodity at a certain price on a specified future date. A futures contract month, also called the “delivery month,” identifies the month and year in which the futures contract ceases to exist and when the contract’s obligation must be fulfilled. If the contract is not offset (sold if one has bought; bought if one has sold) prior to the delivery date, it is settled either by the exchange of the physical commodity, or in cash.

Options on Futures Contracts

A futures contract is an obligation to buy or sell a specific quantity and quality of a commodity at a certain price on a specified future date. A futures contract month, also called the “delivery month,” identifies the month and year in which the futures contract ceases to exist and when the contract’s obligation must be fulfilled. If the contract is not offset (sold if one has bought; bought if one has sold) prior to the delivery date, it is settled either by the exchange of the physical commodity, or in cash.

The Futures Contract- *What is already determined?*

- The commodity
- The quantity
- The quality
- The delivery date
- The delivery point or cash settlements

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

- **Example: Random Length Lumber**

Take the Random Length Lumber futures contract, which trades at the Chicago Mercantile Exchange (CME) as an example. The contract quantity is already determined (110,000 board feet). The lumber quality is also determined (grade stamped Construction and Standard, Standard and Better, or #1 or #2 2x4's of random lengths from 8 feet to 20 feet).

The delivery date of the contract is already decided too. That's when the contract matures. There are six different Lumber futures contracts traded each year, each with a specified delivery date – February, March, May, July, September and November. So when you buy a March Lumber contract, you know the contract matures in March.

The delivery points for Random Length futures contracts are also known. That means if you make or take delivery of 1 Lumber contract (equivalent to 110,000 board feet of Lumber) when the delivery date arrives, you know exactly to which warehouses you can send your truck. (For many commodities, there's a cash settlement instead of delivery of the actual commodity.)

Here's an interesting point to remember. Most people who buy and sell Random Length Lumber futures don't deliver or pick up a load of lumber when the contract matures. They usually offset the trade and get out of the market before that point. They don't really want the Lumber. They've traded the futures contracts for other reasons such as protection against rising or falling lumber prices or simply to earn a profit on the trade.

Options on Futures- *What does an option on a futures contract specify?*

- The commodity and the contract month of the futures contract.
- The right to buy or sell the commodity futures contract.
- The price at which the futures contract will be bought or sold.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

The Futures Exchange

Futures contracts are traded at a futures exchange and *only* at a futures exchange. There are several futures exchanges in the United States. They are:

- The Chicago Mercantile Exchange
- The Sugar, Coffee and Cocoa Exchange
- The New York Mercantile Exchange
- The Chicago Board of Trade

The Clearing Function

One of the most important functions of a futures exchange is to provide a clearing operation. This operation is called the Clearing House. The Clearing House is responsible for clearing trades and for the day-to-day settlement. What does that mean? The Clearing House records all the trades happening in the trading pits each day. At the end of the trading session, it matches or reconciles contracts bought and sold.

The Clearing House also settles the traders' accounts to the market each day. When you buy or sell a futures contract, the exchange requires you to put up a performance bond. That's a cash deposit to cover any loss your investment may incur. Money is added to your performance bond balance if your position earned a profit that day. However, if your position lost money that day, money is subtracted from the balance. And you may get a call to put more money into the account. The Clearing House figures everything out for you.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Contract Settlement

The value of a commodity futures contract ultimately is tied to the underlying product or instrument via each contract's specifications. Not all contracts specify physical delivery, in which the underlying product is transferred to the commodity futures contract buyer by the seller. A number of them are cash settled. Cash settlement allows those who take or make delivery to exchange cash rather than a physical good.

Market Participants

Hedgers and Speculators

Most of those who participate in the futures or options markets can be categorized broadly into one of two groups – hedgers and speculators – depending on whether they are there to transfer risk or accept risk. Brokers are intermediaries who carry out buying and selling instructions from hedgers or speculators.

Hedgers

Hedgers are market participants who want to transfer risk. They can be producers or consumers. A producer hedger wants to transfer the risk that prices will decline by the time a sale is made. A consumer hedger wants to transfer the risk that prices will increase before a purchase is made.

Speculators

A *speculator* takes a position in the futures or options market in the hope of generating profit. If a speculator takes a long position and the market price goes up, the position is profitable. Likewise, profits accrue on a short position as market prices drop.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

What is Margin?

Futures performance bond, or good faith money, also known as margin money, work differently than margins in the stock market. For stocks, if you do not pay in full, the amount you do pay is known as margin and you borrow the rest. The government sets the maximum amount you can borrow.

In futures, however, your performance bond is not partial payment of the product at all, but an amount posted with the exchange to ensure performance in case the market moves against you in the future. In effect, your maximum possible next day's losses are escrowed in advance. Because no one knows which way the market will move, both buyers and sellers post performance bonds. The net result is great confidence among all parties that their gains will be there if the market moves in their favor, because those gains come directly and immediately from those taking the opposite side of the market.

A *margin call* is made by the exchange when an account's value goes below maintenance minimums which are set by the exchanges. The amount of the margin call will be the amount that is needed to bring the account value back to the maximum maintenance level; which is the initial margin level needed to put the trade on.

More on Options *Puts and Calls*

An *option* is the right, but not the obligation, to buy or sell an underlying futures contract at a specified price. For example, you could purchase an option to buy a November Swiss franc futures contract at 88¢ per Swiss franc (an option to buy is a "call" option).

What do you do once you buy the Swiss franc option? You watch price movement. Suppose the November Swiss franc futures price rises above 88¢. You could exercise the option and assume a long November Swiss franc futures contract. You would have bought futures contract at 88¢

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

that you could sell immediately at the higher price. But you don't have to. With prices above 88¢, your option would have increased in value, so you could choose to offset it by selling back the same option at a profit. If the futures price falls below 88¢, the option would have decreased in value. Then you can simply forget about it and let it expire, losing the money you paid for it.

Puts and calls

There are special names for options, depending on whether the option is for the right to buy or the right to sell a futures contract.

A *put* option is the right, but not the obligation, to sell a futures contract at a particular price.

A *call* option is the right, but not the obligation, to buy a futures contract at a particular price.

How do we remember what direction the put and call represents? One way is to remember it is that we call someone up and put someone down. Get it? Call up, put down.

Open Outcry

Much of the trading futures and options contracts are conducted in trading pits on an exchange floor via a system known as "open outcry". This public auction system, dating to the beginning of organized futures markets, ensures that trades are executed at the market's best prevailing price.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

How to Read Prices

Finding futures and options prices is fairly easy. But how do you decipher what you see or hear? Although the amount of information published by a source often differs, here are some standard terms you'll need to know:

Open:	The average price at which the first bids and offers were made or the first transactions were completed.
High:	Top bid or top price at which a contract was traded during the trading period.
Low:	Lowest offer or the lowest price at which a contract was traded during the trading period.
Settlement price:	The official daily closing price.
Net change:	The amount of increase or decrease from the previous trading period's settlement price.
Life-of-contract:	The highest price or bid and the lowest price or offer highs and lows reached in the lifetime of a futures contract or a specific delivery month.
Volume:	The number of contracts traded (one side of each trade only) for each delivery month during the trading period.
Open interest:	The accumulated total of all currently outstanding contracts (one side only). Refers to unliquidated purchases and sales.

The Trading Plan

A well-organized trading plan and the *discipline* to follow it are essential elements of a successful trading program. That's because futures and options on futures are not long-term investments that you can just buy and forget. They require monitoring on a daily (or even an hourly) basis because of the large impact a small price move can have on your account. Your futures and options broker is crucial in helping you to develop your plan and to stay alert to important market changes.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Short and Long Positioning

In futures and options you can buy and sell in whatever order you want; it's just as easy to sell and buy back low, as it is to buy low and sell at a higher price. If you think prices are going up, establish a "long" (buy) position, and if you think prices are going down, initiate a "short" (sell) position.

Money Management

The initial margin requirement is relatively small compared to the value of the contract, and the resulting leverage can lead to quick and substantial profits or losses. (In fact, it's possible to lose more than the amount of money you've deposited.) A good rule of thumb is to use only funds that you can afford to lose without affecting your lifestyle. And, only a portion of these should be devoted to any one trade. Remember, not every trade will be a "winner". Some very successful traders may only "win" on 30-40% of their trades. The key is to cut your losses short, and to let your profits run.

The Leverage of Futures Markets

In the futures markets, leverage means that you need only commit a little money to control a lot of product. When you initiate a futures position, you usually only put up an initial margin of about 5% to 10% of the value of the position.

Here's how quickly a substantial move can occur: In April and May of 1994, June live cattle futures plunged \$11 per hundredweight (cwt.) over 32 trading days as the number and weight of cattle on feed increased. A trader who sold a June cattle contract at \$74/cwt. on a margin of \$700 earned close to \$4,400 as prices fell to \$63/cwt. ($\$11 \text{ gain/cwt.} \times 400 \text{ cwt.}$) for a return of 628% on the initial investment in little more than a month.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Conversely, when supermarkets featured more beef just prior to the July 4th holiday, a trader could have bought an August live cattle contract at \$62/cwt. and sold that contract back in mid-July for \$69/cwt., for a gain of close to \$2,800 on an initial margin of \$700, or a 400% return. (Of course, remember that it's just as easy to sustain a loss, as it is to realize a gain in these markets.)

Is Futures Trading for YOU?

Do YOU have what it takes?

- Can you make decisions under pressure?
- Are you competitive?
- Would you like an intellectual hobby?

If you believe that you have the patience and drive to enter into the commodity futures markets, call the professionals at Midwest Futures, Inc. at 1-800-672-8303 for further information on how to get started, today!

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Trading 101

Notice:
There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

How to Start Trading

Getting started trading commodity futures and options with Midwest Futures can be relatively simple. Once we have designated the right broker for you, you can open a trading account. To do this you must sign a variety of documents, which are provided for your financial security. (Be sure to read them carefully and ask questions if there is something you do not understand.) Then, you must deposit a performance bond, known as a margin deposit or a good faith deposit, generally in the form of cash or certain securities. For information on getting started in futures and options trading, contact one of our licensed brokers or call us toll free at (800) 672-8303.

Tracking Your Trades

“What’s the current price?” is the first and most important question you must answer when you’re trading. Price information is available from:

- Brokers
- Quote vendors
- Major daily and weekly newspapers
- On-line computer information services
- Private advisory services
- Financial programs on television and radio

It is also vital to know that when trading managed futures, the current prices are available to you from your Commodity Trading Advisor (CTA).

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Trading Styles

Trading decisions typically are based on the opinion that a market's fundamental or technical outlook is going to change. Fundamentals include the market's supply and demand forces; technicals encompass a wide range of charting techniques involving a market's price, cycles or volatility.

Fundamentals:

Fundamentals can be summed up in two words – supply and demand. The first traders to know or anticipate the changes in supply and demand have the edge.

Technicals:

Many traders make decisions based on technical indicators. Chart price patterns, cycles, momentum indicators, volume, open interest and mathematical calculations are some of the technical indicators used by technical traders.

The most common starting point for technical analysis is the bar chart, which plots a trading period's opening, high, low and closing prices. Traders watch for new highs and lows, broken trend lines and other patterns that are used as entry and exit points.

Many people prefer to use charts to trade because the price includes all fundamentals and technicals known to the commodity futures market.

The Trading Process

Trading decisions typically are based on the opinion that a commodity's fundamental or technical outlook is going to change. But thinking one knows what the market is going to do is the single most destructive way to trade. You may believe something and you may be right but it does not mean you will be right the next time.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Always be prepared to get out when the prior hits a preset area. Don't think you know more than the market.

Executing an Order

Once you've made your trading decision, you would then contact your commodity futures broker. After you give the broker the buy or sell order, it is transmitted directly to the trading floor via telephone or data transmission lines. Upon receipt, the order is time-stamped and delivered to the trading area, or pit, by an order clerk or runner. The trading pits are each divided into a number of sections designated for trading in particular contract months. No trading may occur outside a contract's assigned pit, nor is trading permitted at any time other than during those hours which have been designated by the Exchange.

Floor Broker Responsibilities

An individual floor broker is responsible for executing your order. Floor brokers are licensed by the federal government to execute trades for the public.

Price Limits

Most futures markets have daily price limits; which mean that prices can move only a certain amount in any trading day. These limits are determined by the Exchange Clearing House (with Commodity Futures Trading Commission (CFTC) approval) on the basis of variations experienced in the underlying cash markets, and are adjusted from time to time as price volatility changes. In some commodities, the contract month trades without limits for a short period before its expiration. Price limits also allow time for collecting margin calls.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Contracts Traded

Whenever a commodity is actively bought and sold in the cash market and there are enough people who could benefit from having a futures contract for that commodity, an exchange can decide to introduce a new futures contract for that product.

There are many commodities that have contracts on them. There are meats such as hog, cattle, feeder cattle and pork bellies. There are grains such as corn, soybeans, wheat, oats, barley and canola. Maybe you want to trade in the currencies, which include contracts on yens, francs, dollars, euros and many more. Also you may want to try your hand in the Softs, which includes such commodities as sugar, cocoa, coffee and cotton. The list goes on and on.

Regulation Authorities

There are three regulation authorities.

1. The Commodity Futures Trading Commission (CFTC)
2. The National Futures Association (NFA)
3. The commodity exchanges

The CFTC is the independent federal regulatory agency that oversees the US futures markets and exchanges.

The NFA is a CFTC authorized organization that handles the registration and licensing of all the industry participants who are exchange members. These members are anyone who as brokerage firm employees, have contact with the public or someone that manages a trading account for a public customer.

The commodity exchanges set margin requirements as well as establishing contract specifications.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Supply and Demand

The price of agricultural commodities fluctuate, foreign exchange rates change from minute to minute, and interest rates and equity indexes rise and fall. Nothing stays the same. That is why a clear understanding of supply and demand is necessary when trading commodity futures.

Supply - *How Much Product?*

Supply is defined as the quantity of a product that sellers are willing to provide to the market at a given price. When prices are high, sellers are willing to provide larger amounts of their products to the market. It's human nature. When prices are low, sellers are willing to provide smaller amounts to the market. This relationship between product supply and its price is called the law of supply.

Many economic factors can cause supply to increase or decrease, and that causes the supply curve to shift. But let's talk real life. When cattle prices are low, there's not much incentive for cattle producers to provide cattle to the market. If cattle prices rise, so does the incentive to provide more cattle. Other things can happen to affect supply. The price of feed may be low, encouraging more cattle production, or too high, causing producers to cut back on production. Each commodity has its own supply factors – even currency, interest rate and equity stock index products. But supply is only half the story.

Demand - *How much need is there?*

Demand is defined as the quantity of a product that buyers are willing to purchase from the market at a given price. When prices are high, buyers are willing to buy less of the product. When prices are low, buyers are willing to buy greater quantities of the product. This relationship between product demand and its price is called the law of demand.

Many economic factors can cause demand for a product to increase or decrease, causing the demand curve to shift. You can imagine how the demand for beef can change depending on its supermarket price or how people feel about eating beef. And it's fairly

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

easy to see how economic conditions could change the demand for credit or the demand for a foreign currency. Each commodity has its own demand factors.

The Market Price - *Reality or the Perception of Reality?*

The price of a product or a commodity depends on the relationship between supply and demand. As a whole, prices will go up when demand exceeds supply and prices will go down when supply exceeds demand.

Fundamental Analysis

Fundamental analysis is the study of the factors that affect supply and demand. The key to fundamental analysis is to gather and interpret this information and then to act before this information is incorporated into the futures price. This lag time between an event and its resulting market response presents a trading opportunity for the fundamentalist.

Agricultural Analysis

For livestock, the fundamental trader studies both supply and demand. The U.S. Department of Agriculture releases several monthly and quarterly reports that supply statistics. Inflation, consumer tastes, consumption patterns and population numbers all affect the demand for meat. The fundamental trader puts all these factors into sophisticated models to try to determine where livestock prices are going.

Financial Analysis

As you would expect, trading financial futures calls for a study of entirely different supply and demand factors. The overall health of the economy is a key factor to watch. Economic reports such as the Leading Indicator Index, Consumer Price Index, Gross National Product and the Employment Situation are only a few of the reports providing information.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

For example, changes in the economy's direction normally signals major interest rate turning points. This is obviously important to anyone trading interest rate futures such as U.S. Treasury bills. The demand for money rises during economic expansion, causing interest rates to rise. Likewise, the demand for money falls during economic recession, causing interest rates to fall. The fundamentalist can also study the relationship of long-term and short-term interest rates to predict the direction of interest rate movement.

Technical Analysis - *Reacting Before the News*

This approach to price prediction is based on the premise that price movements follow consistent historical patterns. Those who engage in technical analysis study charts or statistics that measure price movements and try to find repetitive patterns. They start with the basic bars chart that plots high, low and closing prices of a futures contract over the life of the contract. Current activity is watched carefully for familiar patterns of price movement.

The uptrend, downtrend and sideways trend patterns experienced in the past can alert a chartist to such a movement forming in the current market.

The chartist also watches daily volume numbers (the number of contracts traded each day) and open interest numbers (the number of contracts not yet offset). These numbers are used to assess the strength of a trend.

What patterns does a chartist look for?

As the days during the life of a futures contract pass, the chartist watches for price reversal patterns and price continuation patterns. That is, if prices are headed up, are they going to reverse themselves and head down? If prices are headed down, are they going to start moving up? Or will prices keep heading in the same direction? There are many technical patterns that are used to trade off of. Be consistent on which ones you use. Don't jump from one to another or you will not have the discipline to stay with a trade. You will always be able to find a reason to get out if you use too many indicators.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Glossary

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

The following definitions are not intended to state or suggest the correct legal significance or meaning of any word or phrase. The sole purpose of this compilation is to foster a better understanding of futures and options on futures.

A

Arbitrage

The simultaneous purchase and sale of identical or equivalent financial instruments or commodity futures in order to benefit from a discrepancy in their price relationship.

Ask

(Also called “offer”)

Indicates a willingness to sell a futures contract at a given price.

B

Back Months

The futures or options on futures months being traded that are furthest from expiration.

Bear

One who believes prices will move lower.

Bear Market

A market in which prices are declining.

Bid

The price that the market participants are willing to pay.

Bull

One who expects prices to rise.

Bull Market

A market in which prices are rising.

C

Cabinet Trade

(Also known as a “Cab”)

A trade that allows options traders to liquidate deep out-of-the-money options by trading the option at a price equal to one-half tick.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Call

An option to buy a commodity, security or futures contract at a specified price anytime between now and the expiration date of the option contract.

Cash Commodity

The actual physical commodity as distinguished from a futures commodity.

Close

The period at the end of the trading session. Sometimes used to refer to the closing range.

Closing Range

The high and low prices, or bids and offers, recorded during the period designated as the official close.

Commission

(Also known as a “Round Turn”)

The fee charged by a broker to a customer when a futures or options on futures position is established or offset.

CFTC

The Commodity Futures Trading Commission as created by the Commodity Futures Trading Commission Act of 1974. This government agency currently regulates the nation’s commodity futures industry.

Contract

Unit of trading for a financial or commodity future. Also, actual bilateral agreement between the parties (buyer and seller) of a futures or options on futures transaction as defined by an exchange.

Contract Month

The month in which futures contracts may be satisfied by making or accepting delivery.

D**Day Order**

An order that is placed for execution during only one trading session. If the order cannot be executed that day, it is automatically cancelled.

Day Trading

Refers to establishing and liquidating the same position or positions within one day’s trading, thus ending the day with no established position in the market.

Deferred

(Another term for “back months”)

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Delivery

The tender and receipt of an actual commodity or financial instrument, or cash in settlement of a futures contract.

E

Exercise Or Strike Price

The price at which the holder (buyer) may purchase or sell the underlying futures contract upon the exercise of an option.

Expiration Date

The last day that an option may be exercised into the underlying futures contract. Also, the last day of trading for a futures contract.

F

Floor Broker

An exchange member who is paid a fee for executing orders for Clearing Members of their customers. A Floor Broker executing orders must be licensed by the CFTC.

Floor Trader

An exchange member who generally trades only for his/her own account or for an account controlled by him/her. Also referred to as a “local”.

Futures

A term used to designate all contracts covering the purchase and sale of financial instruments or physical commodities for future delivery on a commodity futures exchange.

Futures Commission Merchant

A firm or person engaged in soliciting or accepting and handling orders for the purchase or sale of futures contracts, subject to the rules of a futures exchange and, who, in connection with solicitation or acceptance of orders, accepts any money or securities to margin any resulting trades or contracts. The FCM must be licensed by the CFTC.

G

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

H

Hedge

The purchase or sale of a futures contract as a temporary substitute for a cash market transaction to be made at a later date. Usually it involves opposite positions in the cash market and futures market at the same time.

Holder

One who purchases an option.

I

Initial Performance Bond

The funds required when a futures position (or a short options on futures position) is opened. (Previously referred to as Initial Margin)

J

K

L

Limit Order

An order given to a broker by a customer that specifies at price; the order can be executed only if the market reaches or betters that price.

Liquidation

Any transaction that offsets or closes out a long or short futures position.

Long

One who has bought a futures or options on futures contract to establish a market position through an offsetting sale; the opposite of short.

Long Hedge

The purchase of a futures contract in anticipation of an actual purchase in the cash market. Used by processors or exporters as protection against and advance in the cash price.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

M

Maintenance Performance Bond

(Previously referred to as a “Maintenance Margin”)

A sum, usually smaller than – but part of – the initial performance bond, which must be maintained on deposit in the customer’s account at all times. If a customer’s equity in any futures position drops to, or under, the maintenance performance bond level, a “performance bond call: is issued for the amount of money required to restore the customer’s equity in the account to the initial margin level.

Mark-To-Market

The daily adjustment of margin accounts to reflect profits and losses.

Market Order

An order for immediate execution given to a broker to buy or sell at the best obtainable price.

Maximum Price Fluctuation

The maximum amount the contract price can change, up or down, during one trading session, as stipulated by Exchange rules.

Minimum Price Fluctuation

Smallest increment of price movement possible in trading a given contract often referred to as a “tick”.

M.I.T.

(Market-If-Touched)

A price order that automatically becomes a market order if the price is reached.

N

National Futures Association (NFA)

Authorized by Congress in 1974 and designated by the CFTC in 1982 as a “registered futures association,” NFA is the industry wide self-regulatory organization of the futures industry.

National Introducing Brokers Association (NIBA)

NIBA is a non-profit organization for guaranteed and independent introducing brokers.

Nearby

The nearest active trading month of a futures or options on futures contract. Also referred to as “lead month”.

Notice Day

Any day on which a clearinghouse issues notices of intent to deliver on futures contracts.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

O

Offer

(Also called “ask”)

Indicates a willingness to sell a futures contract at a given price.

Offset

Selling if one has bought, or buying if one has sold, a futures or options on futures contract.

Open Interest

Total number of futures or options on futures contracts that have not yet been offset or fulfilled by delivery.

Open Order

An order to a broker that is good until it is canceled or executed.

Opening Price

The range of prices at which the first bids and offers were made or first transactions were completed.

Option

A contract giving the holder the right, but not the obligation, to buy or sell a futures contract in a given commodity at a specified price at any time between now and the expiration of the option contract.

Out-Trades

A situation that results when there is some confusion or error on a trade. A difference in pricing, with both traders thinking they were buying, for example, is a reason why an out-trade may occur.

P

Position

The current place in the market, either long or short, in the form of open contracts.

Performance Bond

(Previously referred to as “Margin”)

Funds that must be deposited as a performance bond by a customer with his or her broker, by a broker with a clearing member, or by a clearing member, with the Clearing House. The performance bond helps to ensure the financial integrity of brokers, clearing members and the Exchange as a whole.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Performance Bond Call

(previously referred to as “Margin Call”)

A demand for additional funds because of adverse price movement.

Premium

1. The excess of one futures contract price over that of another, or over the cash market price.
2. The amount agreed upon between the purchaser and seller for the purchase or sale of a futures option – purchasers pay the premium and sellers (writers) receive the premium.

Put

An option to sell a commodity, security, or futures contract at a specified price at any time between now and the expiration of the option contract.

Q**R****Rally**

An upward movement of prices following a decline.

Range

The high and low prices or high and low bids and offers, recorded during a specified time.

Registered Representative

A person employed by, and soliciting business for, a commission house or Futures Commission Merchant.

Round-Turn

The establishing and exiting of a position.

S**Scalp**

To trade for small gains. Scalping normally involves establishing and liquidating a position quickly, usually within the same day, hour or even just a few minutes.

Settlement Price

A figure determined by the closing range that is used to calculate gains and losses in futures market accounts. Settlement prices are used to determine gains, losses, margin calls, and invoice prices for deliveries.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Short

One who has sold a futures contract to establish a market position and who has not yet closed out this position through an offsetting purchase.

Short Hedge

The sale of a futures contract in anticipation of a later cash market sale. Used to eliminate or lessen the possible decline in value of ownership of an approximately equal amount of the cash financial instrument or physical commodity.

Speculator

One who attempts to anticipate price changes and, through buying and selling futures contracts, aims to make profits; does not use the futures market in connection with the production, processing, marketing or handling of a product. The speculator has no interest in making or taking delivery.

Spread

The simultaneous purchase and sale of futures contracts for the same commodity or instrument for delivery in different months, or in different but related markets. A spreader is not concerned with the direction in which the market moves, but only with the difference between the prices of each contract.

T**Tick**

Refers to a change in price, either up or down.

Trend

The general direction of the market.

U**Uncovered Option**

A short call or put option position which is not covered by the purchase or sale of the underlying futures contract or physical commodity. Also referred to as a Naked Option.

Underlying Futures Contract

The specific futures contract that the option conveys the right to buy (in case of a call) or sell (in the case of a put).

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

V

Variable Limit

A price system that allows for larger than normal allowable price movements under certain conditions. In periods of extreme volatility, some exchanges permit trading at price levels that exceed regular daily price limits.

Variation Margin

Additional margin required to be deposited by a clearing member firm to the clearinghouse during periods of great market volatility or in the case of high-risk accounts.

Volatility

A measurement of the change in price over a given time period.

Volume

The number of transactions in a futures or options on futures contract made during a specified period of time

W

Writer

An individual who sells an option.

X

Y

Yield

A measure of the annual return on an investment.

Yield Curve

A chart in which yield level is plotted on the vertical axis, and the term to maturity of debt instruments of similar creditworthiness is plotted on the horizontal axis.

Z

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.

Risk Disclosure

There is a risk of loss in futures and options trading. Past performance is not indicative of future results. This information is not to be construed as an offer to sell or a solicitation or an offer to buy the commodities herein named. The factual information of this report has been obtained from sources believed to be reliable, but is not necessarily all-inclusive and is not guaranteed as to the accuracy, and is not to be construed as representation by Midwest Futures, Inc. The risk of trading futures and options can be substantial. Each investor must consider whether this is a suitable investment. Past performance is not indicative of future results.

Notice:

There is a risk of loss in futures and options trading. Past performance is not indicative of future results.