FUTURES

FUTURES CONTRACT - contract to sell (deliver) or buy (take delivery of) a standardized quantity (or dollar amount) of an asset on a set date (settlement date)

COMMODITY FUTURES

Agriculture
Metals
Energy

FINANCIAL FUTURES

Foreign Currencies
Debt Instruments
Stock Indexes

FUTURES EXCHANGES

FUTURES CLEARINGHOUSE

TRADING

Short Position
Long Position
Margin
Mark to Market
Margin Maintenance
Minimum Price Change
Daily Maximum Price Change
Open Interest
Settlement Price
Basis

Basis = Cash Price - Futures Price

HEDGING

Short Hedge
Long Hedge

SPECULATING

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HEDGING EXAMPLE:

Corn: 5,000 bushel contract

Cash (Spot) Price = 2.01/bu
Dec Futures Price = 2.31/bu

Farmer will have 5,000 bushels to harvest and sell in December
Kellogg will need to buy 5,000 bushels for manufacturing in December

Farmer has corn (long position) and needs to sell (short position) it in December

   Farmer is long corn and needs to go short in the Futures Contract

   Farmer sells (goes short) one December contract

Kellogg needs corn (short position) and needs to buy (long position) in December

   Kellogg is short corn and needs to go long in the Futures contract

   Kellogg buys (goes long) one December contract
At expiration, Futures price must equal Spot price

Assume corn is selling at end of December at:

1) 2.31/bu (December spot price)

   Farmer buys one contract to close position

   Sold @ 2.31 and bought @ 2.31   Profit = .00
   Final price = 2.31 + .00 = 2.31/bu

   Kellogg sells one contract to close position

   Bought @ 2.31 and sold @ 2.31   Profit = .00
   Final price = 2.31 + .00 = 2.31/bu

2) 2.81/bu (December spot price)

   Farmer buys one contract to close position

   Sold @ 2.31 and bought @ 2.81   Loss = -.50
   Final price = 2.81 - .50 = 2.31/bu

   Kellogg sells one contract to close position

   Bought @ 2.31 and sold @ 2.81   Profit = .50
   Final price = 2.81 - .50 = 2.31/bu

3) 1.81/bu (December spot price)

   Farmer buys one contract to close position

   Sold @ 2.31 and bought @ 1.81   Profit = .50
   Final price = 1.81 + .50 = 2.31/bu

   Kellogg sells one contract to close position

   Bought @ 2.31 and sold @ 1.81   Loss = .50
   Final price = 1.81 + .50 = 2.31/bu