

Commodity Futures and Options Terminology

This guide provides basic definitions of commodity futures and options terminology. Although the terminology of trading agricultural commodities goes far beyond the scope of this guide, this information can be used to build a knowledge base from which a broader understanding of the futures and options markets can be developed.

arbitrage The simultaneous purchase and sale of similar commodities in different markets to take advantage of a perceived price discrepancy.

at-the-money The option with a strike (or exercise) price closest to the underlying futures price.

backwardation Market situation in which futures prices are lower in succeeding delivery months. Also known as an inverted market. The opposite of contango.

basis The difference between the current cash price and the futures price of the same commodity for a given contract month.

bear market A period of declining market prices.

bull market A period of rising market prices.

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

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 of the option.

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. Also referred to as cost of carry.

carryover Last year’s ending stocks of a storable commodity.

cash (spot) market A place where people buy and sell the actual (cash) commodities, i.e., a grain elevator, livestock market or the like.

commission (brokerage) fee A fee charged by a broker for executing a transaction.

commodity exchange An exchange that lists designated futures contracts for the trading of various

types of derivative products and allows use of its facilities by traders. Must comply with rules set forth by the Commodity Futures Trading Commission (CFTC).

Commodity Futures Trading Commission

(CFTC) The CFTC is an independent agency of the U.S. government created in 1974 that regulates futures and option markets.

contango market A market situation in which prices are higher in the succeeding delivery months than in the nearest delivery month. Opposite of backwardation.

convergence A term referring to cash and futures prices tending to come together as the futures contract nears expiration.

cross-hedging Hedging a 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. For example, hedging cull cows on the live cattle futures market.

daily trading limit The maximum price change set by the exchange each day for a contract.

day traders Speculators who take positions in futures or options contracts and liquidate them before the close of the same trading day.

delivery The transfer of the cash commodity from the seller of a futures contract to the buyer of a futures contract.

delta The measure of the price-change relationship between an option and the underlying futures price. Equal to the change in premium divided by the change in futures price.

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

exercise To invoke the right granted under the terms of an options contract to buy or sell the underlying futures contract. The option holder (long) is the one who exercises the option. Call holders exercise the right to buy the underlying future, while put holders exercise the right to sell the underlying future. The short option holder is assigned a position opposite to that of the option buyer. CME Clearing removes the

option and creates the futures positions on the firms' books on the day of exercise.

exercise or strike price The price at which the buyer of a call can purchase the commodity during the life of the option, and the price at which the buyer of a put can sell the commodity during the life of the option.

first notice day The first day on which a notice of intent to deliver a commodity in fulfillment of a futures contract can be made by the clearinghouse to a buyer. The clearinghouse also informs the sellers who they have been matched up with.

forward (cash) contract A cash contract in which a seller agrees to deliver a specific commodity to a buyer at a specific time in the future.

fundamental analysis A method of anticipating future price movement using supply and demand information.

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 determined on an exchange trading floor.

Globex Globex refers to CME Globex, an electronic trading platform.

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 costs of the commodity may change before it can be either bought or sold 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 and at the same time as the cash transaction occurs.

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.

implied volatility The volatility implied by the market price of the option based on an option pricing model. In other words, it is the volatility that, given a particular pricing model, yields a theoretical value for the option equal to the current market price.

initial margin The amount a futures market participant must deposit into a margin account at the time an order is placed to buy or sell a futures contract.

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.

intrinsic value The difference between the strike price and the underlying futures price for an option that is in-the-money.

liquidate To offset an existing position.

long position One who has bought futures contracts or plans to own a cash commodity.

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

National Futures Association (NFA) NFA is an independent self-regulatory organization for the U.S. futures industry with no ties to any specific marketplace.

nearby (delivery) month The futures contract month closest to expiration. Also referred to as spot month.

near-the-money The relationship between an option's strike price and the value of the underlying instrument where the strike price is near the underlying instrument's current market price.

offset To remove an open position from an account by establishing a position equal to or opposite the existing position, making or taking delivery, or exercising an option (i.e., selling if one has bought, or buying if one has sold).

open interest For a given commodity, the total number of futures or options contracts that have been neither offset by an opposite futures or option transaction nor fulfilled by delivery of the commodity or option exercise. Each option transaction has a buyer and a seller, but for calculation of open interest, only one side of the contract is counted.

open position A long or short position that has not been liquidated.

option A contract that conveys the right, but not the obligation, to buy or sell a futures contract at a certain price for a specified time period. Only the seller (writer) of the option is obligated to perform.

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.

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.

overbought A technical opinion of a market which has risen too high in relation to underlying fundamental factors.

oversold A technical opinion of a market which has fallen too low in relation to underlying fundamental factors.

price limit The maximum daily price fluctuations on a futures contract during any one session as determined by the Exchange. Also known as limit.

purchasing hedge (long hedge) Buying futures contracts to protect against a possible increase in the price 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.

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 of the option.

retacement A price move in the opposite direction of a recent trend.

selling hedge (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.

short position One who has sold futures contracts or plans to sell a cash commodity. Selling futures contracts or initiating a cash forward contract sale without offsetting a particular market position.

speculator A market participant who tries to profit from buying and selling futures and option contracts by anticipating future price movements. Speculators assume market price risk and add liquidity and capital to the futures markets. They do not hold equal and opposite cash market risks.

spread The price difference between two related markets or commodities. For example, the April to August live cattle spread.

strike price The price at which the futures contract underlying a call or put option can be purchased (call) or sold (put). Also called exercise price.

technical analysis Anticipating future price movements using historical prices, trading volume, open interest and other trading data to study price patterns.

time value The amount of money option buyers 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.

underlying futures contract The specific futures contract that can be bought or sold by exercising an option.

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

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

This glossary was adapted from the Commodity Trading Manual, published by the Chicago Board of Trade, Chicago, Ill., 1997 and Glossary, CME Institute, CME Group (<https://www.cmegroup.com/education/glossary.html>).

Original authors: Joe Parcell and Vern Pierce