

CBOT®

Trading In Futures—An Introduction

RATE	MAT	BID	ASKED
6.63	9-09	115:26	115:28
7.25	1-10	119:15	119:17
7.13	6-10	119:06	119:08
6.63	11-10	116:16	116:18
6.25	2-11	112:13	112:15
5.50	3-11	109:20	109:22
6.00	5-11	112:22	112:24
6.25	7-11*	102:15	102:18
6.50	10-11*	104:12	104:14
6.38	11-11	108:20	108:22
6.00	11-11*	102:29	102:30
6.00	12-11*	103:28	103:30
6.00	1-12*	103:24	103:26



1.160 / 1.145	1.160
2 YR NOTES	
99-167 ⁸ / 99-173 ⁸	2.140
98-307 ⁸ / 98-311 ⁴	2.193
98-201 ⁴ / 98-20+	2.224
3 YR NOTES	
99-251 ⁴ / 99-255 ⁸	2.464
100-015 ⁸ / 100-02	2.599
98-261 ⁴ / 98-265 ⁸	2.684
5 YR NOTES	
97-21 / 97-215 ⁸	3.529
95-287 ⁸ / 95-293 ⁸	3.542
98-01 ⁴ / 98-01+	3.557

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INTRODUCTION

The keys to a futures trader's success are typically knowledge, hard work, a disciplined approach and a dedication to master their profession. If you plan to follow this path, this booklet and the Chicago Board of Trade (CBOT) web site at www.cbot.com can help.

What is a Futures Contract?

A futures contract is a legally binding agreement to buy or sell a commodity or financial instrument sometime in the future at a price agreed upon at the time of the trade. While actual physical delivery of the underlying commodity seldom takes place, futures contracts are nonetheless standardized according to delivery specifications, including the quality, quantity, and time and location. The only variable is price, which is discovered through the trading process. As an example, when a trader purchases a December CBOT mini-sized silver contract he is agreeing to purchase 1,000 troy ounces of silver for delivery during the month of December. The quality of the product is standardized so that all December CBOT mini-sized silver futures contracts represent the same underlying product.

Offset

The standardization of futures contracts affords tremendous flexibility. Because futures contracts are standardized, sellers and buyers can exchange one contract for another and “offset” their obligation to take delivery on a commodity or instrument underlying the futures contract. Offset in the futures market means taking another futures position opposite or equal to one’s initial futures transaction. For example, if a trader bought one December CBOT mini-sized silver contract, he must sell one December CBOT mini-sized silver contract before the contracts call for delivery.

Delivery

Traders sometimes joke about having a truckload of soybeans dumped in their front yard as a result of a futures trade. While the potential for delivery is vital to linking cash and futures prices, in reality, very few futures trades result in delivery and as a result of the formal delivery process and facilities, you never have to worry about taking delivery of the soybeans in your front yard.

Delivery on futures positions begins on the first business day of the contract month. Typically, the oldest outstanding long (buy position) is selected to match a short’s (sell position) intention to deliver. Some futures contracts have a cash-settlement process rather than

physical delivery. For instance, if you held a position in the Dow futures contract until expiration, you would simply receive (or pay) the final gains (or losses) on the contract based on the difference between the entry price and final settlement price.

While most futures traders offset their contracts, if a futures contract is not offset, the trader must be ready to accept delivery of the underlying commodity. Futures contracts for most physical commodities, such as grains, require market participants holding contracts at expiration to either take or make delivery of the underlying contract. It’s this responsibility to make or take delivery that forces futures prices to reflect the actual cash value of the commodity.

Profit Opportunities with Futures

Long or Short

With futures, the trader can profit under a number of different circumstances. When the trader initially purchases a futures contract he is said to be “long,” and will profit when the market moves higher. When a trader initially sells a futures contract he is said to be “short” and will profit when the market moves lower. Going short in a futures market is much easier than going short in other markets. Other markets sometimes require the trader to

actually own the item he is shorting, while this is not the case with futures. Like most other markets, a profit is obtained if you initially buy low and later sell high or initially sell high and later buy low.

Why Trade a Futures Contract?

Leverage

One of the key benefits of trading in the futures markets is that it offers the trader financial leverage. Leverage is the ability of a trader to control large dollar amounts of a commodity with a comparatively small amount of capital. As such, leverage magnifies both gains and losses in the futures market. For example, if a trader buys one soybean contract (5,000 bushels) at \$6.50 per bushel (\$32,500 per contract), the required amount to trade, known as “margin,” might be approximately \$1,400 (approximately 4 percent of the contract value), or about 28 cents per bushel. So for \$1,400 the trader can purchase a contract that has a delivery value of \$32,500.

The benefit of leverage is available because of the margin concept. When you buy a stock, the amount of money required is equal to the price of the stock. However, unlike trading a stock, a futures contract transaction requires both the buyer and seller to post a

performance bond margin. To provide another example, the margin required for a T-bond contract worth \$100,000 may be as little as \$2,400. As you can see, minimum margin requirements represent a very small percentage of a contract’s total value.

To trade a futures contract, the amount you must deposit in your account is called initial margin. Based on the closing prices on each day that you have that open position, your account is either debited or credited daily for you to maintain your position. For example, assume you bought 1 CBOT corn futures contract (5,000 bushels) at a price of \$2.25 per bushel and posted initial margin. At the end of the trading day, the market closed at \$2.30, resulting in a gain of 5 cents per bushel or a total of \$250 (5,000 bushels x \$.05). This amount will then be credited to your account and is available for withdrawal. Losses, on the other hand, will be debited. This process is called market-to-market.

Subsequent to posting initial margin, you must maintain a minimum margin level called maintenance margin. If debits from market losses reduce your account below the maintenance level, you’ll be asked to deposit enough funds to bring your account back up to the initial margin level. This request for additional funds is known as a margin call.

Because margins represent a very small portion of your total market exposure, futures positions are considered highly leveraged. Such “leverage,” the ability to trade contracts with large underlying values, is one reason profits and losses in futures can be greater than trading the underlying cash contract. This can be an attractive feature of futures trading because little capital is required to control large positions. At the same time, a bad trade can accrue losses very quickly. In fact, a trader can lose more than his initial margin when trading futures. This is why successful traders must develop a sound trading plan and exercise great discipline in their trading activities. For specific margin amounts for each futures contract, you can look at the online margin requirements at www.cbot.com.

Liquidity

Another key benefit of futures trading is liquidity. Liquidity is a characteristic of a market to absorb large transactions without a substantial change in the price. Liquid markets easily match a buyer with a seller, enabling traders to quickly transact their business at a fair price. To view liquidity in action you can visit the CBOT web site and view the live “book.” This shows all the bids (to buy) and offers (to sell) on both sides of the CBOT gold contract, for instance. You will notice that within the first five price increments (known as “ticks”) there is typically an average of 300

contracts to either buy or sell. This is considered a very liquid market, meaning that for all practical purposes the trader can buy or sell at a fair price.

Some traders often equate liquidity with trading volume, concluding that only markets with the highest actual number of contracts traded are the most liquid. However, for some contracts, the Chicago Board of Trade has a market maker system in place to promote liquidity. For contracts with a market maker, a trader or firm designated as the market maker then makes two-sided markets (both bids and offers) for a specific quantity.

Transparency

Many futures markets such as those at the CBOT are considered to be “transparent” because the order flow is open and fair. Everyone has an equal opportunity for the trade. When an order enters the marketplace, the order fills at the best price for the customer, regardless of the size of the order. With the advent of electronic trading, transparency has reached new heights as all transactions can be viewed online in real time. In a very general sense, transparency makes all market participants equal in terms of market access.

Financial Integrity

When making an investment, it is important to

have confidence that the person on the other end of the trade will acknowledge and accept your transaction. Futures markets give you this confidence through a clearing service provider system that guarantees the integrity of your trades. Clearing service providers, in conjunction with their clearing member firms, create a two-tiered guarantee system to protect the integrity of futures and options markets. One tier of the system is that the clearing service provider acts as the counterparty to futures and options trades—acting as a buyer to every seller and a seller to every buyer. The other tier is that clearing firms extend their own guarantee to buyers and sellers who are not clearing firms. All firms and individuals who do not hold memberships or ownership interests in the clearinghouse must “clear” their trades through a clearing firm, which then guarantees these trades to the clearinghouse. This allows all market participants to rest easier because clearing firms will make good on the trades they guarantee, even if the original counterparty defaults.

Types of Traders

Traders play a vital role in the futures markets by providing liquidity. While futures are designed primarily to assist hedgers in managing their exposure to price risk, the

market would not be possible without the participation of traders, or speculators, who provide a fluid market of buyers and sellers. Speculators provide the bulk of market liquidity, which allows the hedger to enter and exit the market in a more efficient manner. In summary, the two main categories of traders are hedgers and speculators. Hedgers are those who use the futures market to manage price risk. Speculators, on the other hand, are those who use the futures market for the profit motive. As such, the speculator assumes a market risk for the potential opportunity to earn a profit.

Futures traders can also be categorized in a number of other ways. There are full-time professional traders and part-time traders; traders who trade on the trading floor or behind a computer screen. Each of these market participants plays an important role in making the markets efficient places to conduct business.

Public Traders

The vast majority of speculators are individuals trading off the floor with private funds. This diverse group is generally referred to as “retail” business. With the growing movement from trading on the floor to the computer screen, the retail customer is becoming a more important force in futures trading. Further, with computer-based trading, “leveling the

playing field” between the different types of traders has become a reality.

“Local” Traders

Perhaps the most visible and colorful speculator is the professional floor trader, or local, trading for his own account on the floor of an exchange. Locals come from all walks of life and frequently began their careers as runners, clerks or assistants to other traders and brokers. Locals are usually more interested in the market activity in the trading pit as opposed to the market activity in the underlying market fundamentals. With the popularity of electronic trading sweeping the industry, a trader who operates in a fashion similar to a floor local has emerged—the “electronic local.” The electronic local trades using the same method as the local except they do so through the Internet and a computer rather than in the trading pits of Chicago.

Proprietary Traders

Another major category of trader is the proprietary trader, who works off the floor for a professional trading firm. These “upstairs” traders are employees of large investment firms, commercial banks and trading houses typically located in major financial centers. This group has a number of different trading objectives. Some engage in speculative trading activity, profiting when the market

moves in their direction. Such proprietary traders are compensated according to the profits they generate. Other proprietary traders manage risk, hedging or spreading between different markets—both cash and futures—in order to insulate their business from the risk of price fluctuation or exploiting differences and momentary inefficiencies in market-to-market pricing.

Market Makers

Market makers give liquidity to the market, constantly providing both a bid (expression to buy) and an offer (expression to sell). Increasingly important in electronic markets, market makers ensure that traders of all kinds can buy and sell whenever they want. Market makers often profit from the “spread,” or the small difference between the bid and offer (or ask) prices.

How Traders Trade

Each of the types of traders previously described uses a different strategy to achieve his goals.

Scalpers

A scalper trades in and out of the market many times during the day, hoping to make a small profit on a heavy volume of trades. Scalpers attempt to buy at the bid price and



sell at the ask price, offsetting their trades within seconds of making the original trade. Scalpers rarely hold a position overnight and often don't trade or make predictions on the future direction of the market. Locals and market makers often employ a scalping strategy, which is the most common source of market liquidity.

Day Traders

A day trader is similar to a scalper in that he or she also typically does not hold positions overnight and is an active trader during the trading day. Day traders trade both off and on the floor. A day trader makes fewer trades than a scalper, generally holds his positions for a longer period of time than a scalper, and trades based on a prediction on the future direction of the market. Proprietary traders, locals and public traders are often day traders.

Position Traders

A position trader might make one trading decision and then hold that position for days, weeks or months. Position traders are less concerned with minor fluctuations and are more focused on long-term trends and market forces. Public traders and proprietary traders are often position traders.

How Traders Access the Market

Once you've decided that you want to trade futures, you'll want to determine a strategy to follow and determine how you want your trades executed. If you're new to the markets, it's particularly important to get professional assistance and educate yourself about the various trading strategies and trade execution methods. Professional assistance can come in the form of a full-service broker providing you market and trading advice. Some full-service brokers provide advisory newsletters to give you a sense of how the market operates, and provide more specific advice and trade recommendations. You can find qualified brokers, trading strategies and advisory newsletters at www.cbot.com.

Another trading alternative to gain exposure to the markets is to invest in a managed futures fund, where your money will be pooled with that of many other investors. With this increasingly popular method, a professional fund manager makes trading decisions with the pool of funds. Most major brokerage houses offer managed accounts, as do numerous independent fund operators. You'll want to research the fund's historical performance and the manager's trading style before deciding on the fund in which to invest.

Once you've become fully experienced and want to make your own trading decisions, you may consider using a discount broker for execution purposes only. Numerous discount futures brokerage firms specialize in providing trade executions to both public and proprietary traders. You will also have to decide if you want to trade electronically through the Internet or by calling your discount broker, or both. Additionally, you may want to access advanced charts and trading tools

used by professional and proprietary traders. You can do this by subscribing to services such as those at www.cbtc.com/advantage.

Regardless of your approach, it will be helpful to become familiar with the most important terms and procedures in the futures markets. The next section will introduce you to these basics.

The screenshot displays the Chicago Board of Trade's trading interface. On the left, there is a 'Streaming View' candlestick chart for the 'mini DOW' (YMZ3) with a price range from 9241 to 9251. To the right of the chart is a summary table for the 'mini DOW' showing a last price of 9251, a change of -91, and a time of 11:50. The main focus is a large order book table with columns for 'BUY ORDERS' and 'SELL ORDERS', each with sub-columns for 'QTY' and 'PRICE'. The network time at the bottom is 'Sep-30 11:50:25'.

BUY ORDERS		SELL ORDERS	
QTY	PRICE	QTY	PRICE
44	9250	15	9251
117	9249	31	9252
37	9248	203	9253
49	9247	41	9254
16	9246	29	9255
30	9245	9	9256
12	9244	24	9257
12	9243	28	9258
19	9242	43	9259
2	9241	17	9260

Exchanges such as the Chicago Board of Trade provide real-time access to quotes and online charts of some of their products, such as this live chart of the mini-sized Dow future.

Market Mechanics and Terminology

In order to understand the futures markets, it is essential to become familiar with basic terminology and operations. While trading rules and procedures of each futures exchange vary slightly, these terms tend to be used consistently by all U.S. exchanges.

The Contract and Trading Month

All futures have assigned a unique one- or two-letter code that identifies the contract type. This abbreviation, or ticker symbol, is used by the CBOT electronic clearing platform and others to process all transactions. For instance, the symbol for the Dow Future is DJ, while the symbol for the mini-sized Dow future is YM. This symbol is important when you trade electronically because if you enter the wrong symbol you could trade the wrong contract.

In addition to the contract code, you also need to know the month and year code. For instance, the month code for March is H. So if you were trading the March Dow future in 2005 the code would be DJH5. You can obtain a full list of contract symbols at www.cbot.com.

Contract Pricing in Ticks

It is obviously important to understand a contract's value. This is how you determine profit and loss, as well as entry and exit

Month Codes	
Month	Code
January	F
February	G
March	H
April	J
May	K
June	M
July	N
August	Q
September	U
October	V
November	X
December	Z

pricing. Each futures contract has a minimum price increment called a tick size. The term tick size, or simply tick, dates back to the old ticker tape machines, which were the original means of conveying price information from the trading floor. Traders use the word tick to express the contract's price movement or the amount of their profits or losses.

Another term you will have to understand is the multiplier, which determines the value of each tick. You can determine the value of a day's price movement by multiplying the movement in ticks by the multiplier. For example, suppose the multiplier on the mini-sized Dow future is \$5. If the Dow future moved up 10 ticks in one day, one long contract would have gained \$50 in value (10 index ticks x \$5 multiplier = \$50).

Reading the Prices

In addition to www.cbot.com, numerous national and local newspapers publish futures and options prices, as well as other information such as daily volume and open interest. The table below shows how to read CBOT Dow futures in *The Wall Street Journal*. Current prices and the previous day's settlement prices can be found online at several web sites, including www.cbot.com.

1. The first column indicates the delivery month.
2. Following are the opening price, the high and low price for that day, and the final settlement price. In this case, the June contract settled at 10379.
3. This column indicates how much today's settlement price is higher or lower than the

previous settlement price. In this case, the price of the June contract increased by 129 index points.

4. These two columns display the highest and lowest prices ever reached for each delivery month since the contract began trading.
5. Finally, the total open interest, or outstanding positions, for each contract month is shown.
6. Across the bottom is the total estimated volume for CBOT® DJIASM futures traded on that day, the actual volume from the previous day, the total open interest in all delivery months, and how much open interest has increased or decreased from the prior trading day, including delivery months not shown.
7. Preliminary numbers of the underlying cash market.

DJ Industrial Average (CBT)-\$10 x index								
June	10275	10391	10272	10379	129	10715	9000	45,282
Sept	10300	10370	10280	10363	130	10557	9835	1,949
Est vol 6,754; vol Fri 8,158; open int 47,250, +255.								
Idx prl: Hi 10391.15; Lo 10243.31; Close 10391.08, +148.26.								
Mini DJ Industrial Average (CBT)-\$5 x index								
June	10273	10395	10270	10379	129	10725	9584	55,505
Vol Mon 67,651; open int 57,774, +1,351.								

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Volume and Open Interest

Next to price, volume is the most frequently cited statistic in reference to a futures contract's trading activity. Each unit of volume represents a contract traded. When a trader buys a contract and another trader sells that same contract, that transaction is recorded as one contract being traded. Therefore, the volume is the total number of long or short positions.

Open interest, on the other hand, refers to the number of futures positions that have not been closed out either through offset or delivery. In other words, the futures contracts that remain open, or unliquidated, at the close of each trading session.

To illustrate, assume that a trader buys 15 contracts and then sells 10 of them back to the market before the end of the trading day. His trades add 25 contracts to the day's total volume. Since 5 of the contracts were not offset, open interest would increase by 5 contracts as a result of his activity.

Volume and open interest are reported daily and are used by traders to determine the participation in a market and the validity of price movement. For instance, if a market moves higher on low volume some traders may not consider this an important price movement. However, the same price

movement on high volume would indicate that an important trend may be emerging. Combining volume and open interest also yields an interesting perspective on the market. If a contract experiences relatively low volume levels but high open interest, it is generally assumed that commercial participation is high. This is because commercial hedgers tend to use the markets for longer-term hedging purposes, putting their trades in and keeping them until they're no longer needed to manage a given price risk. Conversely, high volume with low open interest may indicate more speculative market activity. This is because the majority of speculators prefer to get in and out of the market on a daily basis.

The Route of an Order

As a public speculator, your futures trades must go through a registered broker at a Futures Commission Merchant (FCM).

FCMs are brokerage firms licensed to handle customer business in the futures markets. When you instruct your broker to make a trade on your behalf, or when you execute a trade through the computer, the FCM is responsible for routing that trade to the appropriate trading area. Trade confirmations are relayed back to the customer. With computer-based trading,

the whole process happens in a matter of seconds. Verbal orders placed through a human broker can take slightly longer.

Types of Orders

At the most basic level, you can place an order to buy a futures contract (go long) or sell (go short).

There are many different types of orders to enter in the futures markets: a market order, a limit order, and a stop order, to name a few. Your decision about which type of order to use will depend on your trading objectives and market conditions.

It is vital that you and your broker understand and agree on the type of order you are entering. Mistakes can be costly, but can almost always be avoided with clear communication.

Following are the most regularly used orders:

Market Order

The most common type of order is the market order. When you enter a market order, you simply state the number of contracts you want to buy or sell in a given delivery month. You do not need to specify price, since your objective is to have the order executed as soon as possible.

When the order reaches the trading floor, or the electronic matching engine in the case of computer-based trading, it is executed at the best possible bid/ask price at that moment.

The market order is usually filled in a quick fashion at a price based on the current bids and offers.

Limit Order

A limit order specifies a price limit at which the order must be executed. In other words, it must be filled at that price or better. The advantage of a limit order is that you know the worst price (limit price) you'll get if the order is executed, and there is a possibility that the price may be better than your limit. The disadvantage is that your order might not get filled if the market doesn't reach that price level or if the trading activity at that price level is limited.

Stop Order

Stop orders are not executed until the market reaches a given price, at which time the stop order becomes a market order. Some stop orders are referred to as stop-loss orders, which most often are used as a protective measure for gains or limiting losses. Many times a trader will put a stop order in at a predetermined level so that if the market moves against the trader's position it will automatically liquidate the position and limit further losses.

Stop orders can also be used to enter the market. Suppose you expect a bull market only if the price passes through a specified level. In this case, you could enter a buy-stop order to be executed if the market reaches reached this point. For instance, let's say the mini-sized Dow future was trading at 10,500. You could place a sell stop order at 10,540, and when the market reached that level your order will would then become a market order to sell.

One variation is the stop-limit order. With this type of order, the trade must be executed at the exact price (or better) or held until the stated price is reached again. If the market fails to return to the stop-limit level, the order is not executed.

Order Duration

In addition to the type of order, it is also important to determine the duration of an order. Most orders are day orders and work only during that trading session, expiring at the end of the day. On the other hand, open orders, or good 'til canceled (GTC) orders, are worked until the contract expires or the customer cancels the order. Fill or kill orders are placed and then immediately canceled if they do not fill. Market on close orders place a market order at the close of the trading day.

Position and Price Limits

In order to maintain orderly markets, futures exchanges typically set both position and price limits. A position limit is the maximum number of contracts that may be held by a single market participant. While position limits typically apply to speculators, hedgers have position limits that are related to their underlying physical market position.

Price limits, also called daily trading limits, specify a maximum price range allowed each day for a contract. Further, price limits are lifted when the delivery process of a particular contract month begins. Usually, the price limits are removed beginning with the last two business days prior to the contract month. Many traders will usually close out their positions prior to the delivery process, because the volatility may increase beyond a level they prefer. The daily price limits for CBOT futures contracts appear in their individual contract specifications page on www.cbot.com, as do position limits.

What is an Options Contract?

While the focus of this booklet is primarily on futures, it is also important to understand the opportunities options present to the trader. Both futures and options are traded at most major futures exchanges, including the CBOT.

An option is a contract that gives the buyer the right, but not the obligation, to buy or sell a particular futures contract at a fixed price for a specific period of time. The contract also obligates the seller to meet the terms of delivery if the contract right is exercised by the buyer. When someone buys a call option on corn futures, they are buying the right to purchase that underlying corn futures contract at a specific price, known as the strike price, at a future point in time, known as the expiration date. When a trader buys a corn put, they have the right to sell the underlying corn futures contract. Buyers of calls and puts receive these rights in return for paying the value (price) of the rights, known as the option premium. Option buyers have a limited and known loss potential (the amount of premium paid). Due to the rights an option buyer has, their profit potential is virtually unlimited.

On the other hand, speculators could sell calls and puts. They have obligations to fulfill the rights given to the option buyer. In return for these obligations, the option seller receives the premium. Sellers of options have a limited amount of potential gain (the amount of premium received) while they have unlimited loss potential. Most traders that sell options will usually have other positions to offset the risk of their short option position.

Futures Positions After Option Exercise

	Call Option	Put Option
Buyer Assumes	Long futures position	Short futures position
Seller Assumes	Short futures position	Long futures position

Using Fundamental Analysis to Forecast Prices

There are two primary methods traders use to forecast future price movement: Fundamental Analysis and Technical Analysis. We will explore fundamental analysis over the course of the next few pages, then examine technical analysis.

If you could predict the direction of prices with perfect accuracy, you would obviously have no trouble making a fortune in the futures markets. Assuming that you can't, however, an alternative would be to learn the forecasting techniques used by successful traders. One method, called fundamental analysis, is based on market economics, also known as supply and demand information.

Fundamental analysis applies to all markets including agricultural, financial, equity and metals. Much of the fundamental trade centers upon the release of key government reports. If these official reports are in line with the market's expectations, the impact on market prices will be minimal. When actual figures vary from expectations, market prices can respond dramatically.

Days on which key reports are released can present real trading opportunities due to the resulting dramatic swings in price. To take advantage of these opportunities, you must understand the meaning and potential impact of the report, as well as the market's prior expectations. Some brokers pride themselves on their ability to assist you in assessing this information. Some exchanges, like the CBOT, provide intraday market commentary, which usually includes information from the reports and the impact on the markets. This commentary can be found on the CBOT website.

It's also important to keep in mind that price volatility is usually higher on release dates. Even if you don't intend to trade based on a given number, you may find the value of any open positions changing significantly on these days. Of course, this could work to your benefit or your detriment. In any event, it's important to understand the impact of the

major reports and other critical events, regardless of whether or not you intend to trade on fundamental information.

Like any trading method, fundamental analysis has its limitations. Key statistics can be reported inaccurately, resulting in your subjective interpretation of the information being incorrect. New data is always filtering through the markets and creating price changes. Opportunities can come and go before you even have a chance to react. And while one piece of information may point clearly in one price direction, other factors can combine to drive prices the other way.

Although forecasting futures prices is clearly tricky business, all traders face the same set of challenges. It's probably best to concentrate at first on only one or two related futures markets. Since so many factors can influence prices, limiting your efforts in this way will make fundamental analysis a much more manageable task.

The CBOT provides traders with monthly calendars for the agricultural and financial markets that list the economic reports scheduled for release each month. These calendars can be viewed online at www.cbot.com. Whether you choose to focus on agricultural or financial futures markets, a good understanding of

fundamental price information will go a long way toward improving your trading success. But fundamental analysis is just one method.

Using Technical Analysis to Forecast Prices

Technical analysis is another technique. Some traders only use technical analysis to make trading decisions, while others use some combination of fundamental and technical analysis to determine if they want to be long or short and to time their trades.

The technical analyst focuses purely on market information—primarily price movements, but also volume and open interest figures. The pure technician works on the assumption that all fundamental information is already reflected in the price, and that it is more important to study the market’s resulting price behavior. Unlike the fundamental analyst, the market technician is not concerned with understanding the underlying fundamental news surrounding why the market moved. Rather, the technician attempts to predict future price direction by looking at previous patterns of price behavior. For instance, if selling continually occurred at a certain price, the technician would conclude that price point represented “resistance” where sellers would likely emerge in the future to drive prices

down. The technician would then sell at that point on the assumptions that prices would drop.

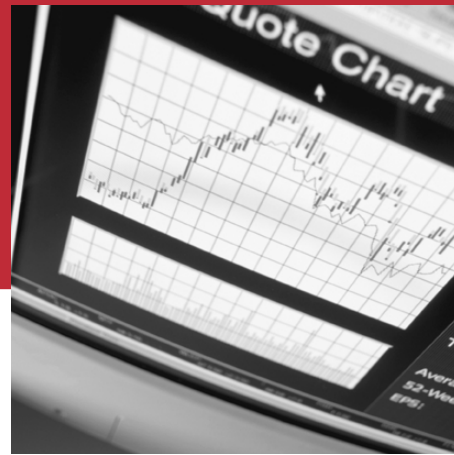
Charts, tables and graphs are the major tools of the technical analyst. Traders can organize and analyze market data in any number of ways depending on their preference.

Traders use charts to identify price trends, special patterns or formations, and areas of support and resistance. Price support occurs where there is sufficient buying of the futures contract to halt a price decline. Resistance, on the other hand, refers to a ceiling where selling pressure can be expected to stop a rally. When the market trades sideways for an extended period of time, it is said to be in a consolidation phase.

Chart Formations

The study of technical indicators is quite extensive, certainly encompassing much more detail than can be provided here. It’s possible, however, to introduce the general concepts of charting and the major chart patterns.

Keep in mind that while a sequence of price movements often indicates the likelihood of future direction, exceptions to past patterns can always occur. The best traders understand how to appropriately interpret these “chart patterns” and often have in place



a back-up plan if the market moves in an unanticipated direction. You can find CBOT charts, such as the live mini-sized Dow chart, online at www.cbot.com to test your skill at interpreting them.

Moving Averages

Moving averages provide another tool for tracking price trends. In its simplest form, a moving average is an average of prices calculated over a given period of time. For example, a 10-day moving average takes the last 10 closing prices, adds them up, and divides by 10. On the next day, the oldest price is dropped, the newest price is added, and these 10 prices are divided by 10 to obtain the average. In this manner, the average “moves” each day.

Moving averages can provide the technician clues to the relative strength or weakness of a given market. For instance, when the market is above its 50-day moving average it is thought that the market is in an uptrend. Some moving averages are also viewed as support and resistance points. In this sense, moving averages provide opportunities for the trader to enter and exit the market. For instance, when a market drops lower to reach a major moving average the trader might choose to go long in the market

Moving averages are said to take the “noise” out of the price movement. This is due in large part to the smoothing effect of a moving average. If an upward-trending market suddenly has one day of lower prices, a moving average would factor that day’s price in with several other days—thus lessening the impact of one trading day on the moving average.

As long as there is generally more buying than selling pressure, the moving average will continue to indicate an uptrend. Conversely, a downtrend will be sustained as long as there is more selling than buying pressure.

To help identify entry and exit points, moving averages are frequently superimposed onto bar charts. When the market closes above the moving average, a buy signal may be generated. As well, a sell signal may result when the market moves below the moving average. Some traders prefer to see the moving average line actually change direction before declaring a buy or sell signal.

The sensitivity of the moving average line relates directly to the length of time chosen for the average. For instance, a 5-day moving average will be more sensitive and will potentially prompt more buy and sell signals than a 20-day moving average. If the average is too sensitive, you may find yourself jumping

in and out of the market too often—paying excessive transaction costs. If the moving average is not sensitive enough, you may miss opportunities by identifying buy and sell signals too late.

Moving averages can be used in any number of ways, and traders develop their personal favorites. Besides selecting the length of time for a moving average, you can also alter the types of prices used. While closing prices are most common, some traders use an average of the high, low and closing prices. Some traders run two moving averages, one of high prices and another of the low prices, effectively creating a channel of prices. It is also possible to weight a moving average line so that the recent prices carry greater impact than older prices.

While experimenting with various moving averages may sound like tedious work, the computer has made this task easier. In any event, you should recognize that a moving average, unlike a chart formation, is not a forward-looking indicator. Rather, it follows the market and identifies only established trending patterns.

Volume and Open Interest

While the primary focus of the technician tends to concentrate on price information, additional insight into the market can be gained by

adding the dimensions of volume and open interest. Volume and open interest are considered confirming indicators, providing clues about how much strength is behind a trend. For example, if volume and open interest increase with prices, it is considered a healthy sign of a solid bull market. The longs are eager to add to their positions, and new longs are attracted to the market. If prices fall momentarily, and volume declines as well, the bull market is probably not in jeopardy since this may reflect only a small sell-off.

Generally, strong volume and increasing open interest support a price trend, regardless of its direction. At the same time, this scenario is more likely to occur in a bull market since many public speculators are more naturally inclined to buy into a rally than to sell into a bear market.

When looking at open interest trends, it's also important to keep a couple of other points in mind. First of all, many of the physical commodity markets (such as grains) have historical open interest patterns, or seasonality factors. For this reason, changes in open interest should be considered in relative terms.

Secondly, many futures contracts will show a sharp drop in open interest as a delivery month approaches expiration. By looking at the behavior of open interest during past

delivery months, you can judge better whether a current open interest trend is stronger or weaker than past patterns.

The technical analysis methods introduced here barely scratch the surface of charting techniques and technical trading systems. Numerous other methods have been developed. Many proprietary trading systems are also available as software programs or online services.

When comparing technical to fundamental analysis, you'll find advantages and disadvantages. The primary advantage of technical analysis is that you can follow several markets much more easily than when using a fundamental approach. If one market isn't doing much, you can monitor others for developing trends.

One disadvantage of technical trading is that you'll find many other traders looking for the same signals you're hoping to identify. As a result, when a distinct chart pattern does develop, many orders may be sitting under the market waiting for the same trigger price. It is important to keep this in mind and to make your decisions carefully about what types of orders to use and how.

Since both technical and fundamental analysis have their strengths and weaknesses, it is unusual to find traders who use one

exclusively. Many will follow fundamentals to get a broader picture of the market, while using technical analysis to fine tune their strategy and select entry and exit points. Yet others who claim to be technicians will keep an eye on the fundamentals to confirm or revise their trading decisions.

Trading Guidelines

Regardless of whether you prefer a fundamental or technical approach to making trading decisions, your ultimate success will hinge largely on your ability to develop good trading habits. Numerous expressions of market wisdom attempt to give guidance. Phrases like "cut your losses and let your profits run" or "the trend is your friend" are helpful but a bit vague. What then are some helpful guidelines that can improve your results? The following 10 rules will go a long way toward getting you started on the right path.

1. Buy low and sell high

This may sound obvious, but since it's the only way to earn trading profits, it bears reporting. Also don't forget that in the futures markets you can easily do the reverse—sell high and buy low. Bulls start their trades with a long (buy) position and bears are initially short (sellers).

For example, if you expected a rally in July wheat futures, you might enter the market with a long (buy) position at \$3.50 per bushel. Over the next two weeks, suppose July wheat futures moved up to \$3.60. If you offset (closed out) your position at this price by selling July wheat futures, you would realize a gain of \$500 (10 cents x 5,000 bushels) per contract.

On the other hand, you might be bearish on T-Note futures. Let's assume you shorted (sold) the December T-Note futures at 102-00. If prices then moved down to 101-00, you could offset (buy back) your December T-Note futures position and make \$1,000 (one full point on a \$100,000 face value bond) per contract traded.

2. Determine the right size for your trading account

The funds you trade should be completely discretionary. In other words, ask yourself if you can afford to lose whatever you invest in that account—and potentially more. Savings for college, retirement or emergencies should not be included.

3. Set definite risk parameters

Before you trade, determine how much of a loss you are willing to accept. You can express this as a dollar figure or as a percent of the margin amount. In either case, you should always keep some money in reserve. By

setting limits up front, you may lessen the risk of emotions dictating your decisions if the market happens to turn against you. Wishful thinking could easily drive you deeper in trouble, but hard and fast parameters are difficult to ignore.

4. Pick the right contract(s)

There are many futures contracts to choose from and several things to consider when deciding which ones are right for you.

Volatility

Futures contracts that experience wider daily trading ranges are considered more volatile and more risky. Soybeans usually have a higher average daily price range compared to corn. Some traders prefer a more volatile contract because the cost of trading (commission fees, for example) is the same, yet the potential for a profit can be greater. Of course, the risk for loss is also greater.

Liquidity

Make sure the futures contract you select has enough volume and open interest to ensure that you can exit your position just as easily as you entered it. Getting current market information (bids and offers and quantities at each) is also helpful. Your broker should be able to provide current market information, and for some products you can view the live markets on the Exchange's website.

Contract Size

For some futures, you can choose between full-sized and mini-sized contracts. Examples of mini-sized CBOT contracts include the \$5 mini-sized Dow future (compared to the \$10 full-sized contract), the mini-sized corn, wheat, and soybeans contracts (compared to the 5,000 bushel full-sized), the mini-sized T-Note or T-Bond contract (50,000 face value compared to the \$100,000 full size), and the mini-sized silver and gold contracts.

While economic factors usually impact both the full-sized and mini-sized contracts, the dollar amount at risk is less with the smaller contract. Further, if your trading account is relatively small, trading smaller contracts allows you to diversify to a degree that may not otherwise be possible. This reduces your risk exposure to any one market. For contract size information, check contract specifications at www.cbot.com.

Margins

Margin levels are a function of contract size and price volatility. While you may be comfortable trading in volatile markets, the size of your account and the margin requirements may limit your selection of which futures contracts to trade. You can check margin requirements of various contracts at www.cbot.com.

5. Diversify

Rather than exposing your entire trading account to a position in one futures contract, it is more prudent to take smaller positions in several contracts. At the same time, you may not want to trade too many markets at once, or you may have a difficult time tracking your positions and following the fundamental information or technical indicators for each market.

6. Have a trading plan

Before you actually enter into a futures position, develop a plan to guide your decision based on careful analysis of the market(s) you plan to trade. The following are some of the issues you'll want to evaluate:

- What is your goal with each trade?
(To hit a given entry and exit price?
To capitalize on an anticipated market indicator? To ride a trend for a specified period of time?)
- How much risk is in each trade?
How much risk are you willing to accept?
- If the trade turns against my position, at what point should you liquidate the position?
- What types of orders will you use?
(In particular, consider the use of stop orders to limit losses?)
- What systems will you use to monitor market developments and price movement?

You can find several strategy papers at www.cbot.com that may be useful in developing a trading plan.

7. Stick to it

Perhaps two of the key elements that differentiate successful traders from the pack are discipline and emotional control. For instance, when the market moves against a trader, past an exit point he had previously established, a good trader can cut loose the trade and accept the loss. Half the battle is having a good plan, the other half is sticking to that plan in the heat of the moment.

8. Begin with simulated trading

While there is no better way to learn when your own money—and emotions—are involved, it's still a good idea to practice first with simulated trading. Pick a couple of markets to follow and experiment with your trading plan.

You can practice trade by using an electronic trading simulator located at www.cbot.com. The advantage of an electronic trading simulator is that some consider it to most closely replicate “real world” trading conditions. Simulated trading is a good way to become familiar with the price quotations, the market terminology, and the general behavior of a particular futures contract.

9. Select a good broker

A broker can play an important role in your success. There are essentially two types of brokers: full-service and discount brokers. Full-service brokers provide more in the way of guidance and research support, but charge higher commissions to execute your trades. Discount brokers leave all the trading decisions to you but charge much less to execute your trades. With the popularity of electronic trading, some discount brokers offer options that allow you to trade entirely through your computer. Additional information on finding a broker can be found at www.cbot.com.

The National Futures Association (NFA) directly supervises the activities of all futures brokers (officially called associated persons). All members of the NFA must observe high levels of conduct that extend beyond legal requirements. The NFA investigates complaints against its members and issues fines and suspensions, if necessary. Contact the NFA or visit the NFA web site (www.nfa.futures.org) if you ever encounter serious problems with or want to check the status of your broker's credentials.



Professional Money Management

If you decide that you don't have the time to dedicate to full-time futures trading but still want to participate in the futures markets, you might consider professional money management.

One possible route is to use a Commodity Trading Advisor (CTA) to manage your funds. If you opt for direct money management, you will have to give your power of attorney to the CTA and sign a risk disclosure document. In turn, the CTA must spell out his or her trading program, past performance, potential risks and fee structure.

CTAs often charge two kinds of fees to manage your money. Almost all will charge an incentive fee based on their trading performance. Some also charge a management fee that is paid regardless of profits earned. Most require a fairly substantial sum to open an account.

Another possibility—particularly for the smaller investor—is to participate in a commodity pool. Commodity pools are conceptually similar to mutual funds. Almost all pools are organized as limited partnerships with the Commodity Pool Operator (CPO) acting as the general partner. The day-to-day trading decisions may be made by the general

partner, or the commodity pool may employ a third party CTA.*

If you're considering joining a pool, you will want to check out the trading manager's track record and review the risk disclosure documents. Also, be certain you know up front how to exit the pool if you so desire. Many pools place limitations on when this can occur.

The primary advantage of using trading advisors or commodity pools is that you will be able to capitalize on someone else's trading expertise and significantly reduce the amount of personal time and effort required for trading. At the same time, professional assistance carries a higher price tag. You will also limit your ability to develop your own expertise. Still, depending on your circumstances and personal goals, professional money management may be a viable option.

*Note that CTAs and larger CPOs must register with the NFA. The NFA can be consulted for background information on CTAs and larger CPOs, or to register a complaint.

Expanding Your Trading

In general, spread trading involves the purchase of one futures or options contract

and the sale of a different but related futures or options contract. More complex spreads can involve more than two contracts. The goal is to profit from changes in the relative price movements between different but similar markets. For example, a MOB (muni over bond) trader may enter a spread position that gains in value when munis outperform T-bonds. Another example would be selling the January CBOT mini-sized Gold futures and buying the April CBOT mini-sized gold futures contract. This is an example of a common spread known as the “calendar” spread. The primary advantage of spread trading is that it generally entails less risk than outright futures positions and, as a result, requires lower margin deposits.

This booklet is only an introduction to futures trading. It has introduced you to techniques that can improve your understanding of the markets and trading results. There are other more sophisticated strategies that you can use to profit that you can investigate by visiting www.cbot.com.

Glossary

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.

Bear - One of the two market directional terms. Bear represents an individual, a market, a strategy, a trend or any other market concept that refers to or benefits from a “declining” market. Example. I am bearish on the silver market so I am going to short a CBOT mini-sized silver futures contract.

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

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 - One of the two market directional terms. Bull represents an individual, a market, a strategy, a trend or any other market concept that refers to or benefits from a “rising” market. Example. I am bullish on the stock market so I am going to go long a CBOT mini-sized Dow Futures contract.

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.

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.

Cash Settlement - Transactions involving futures contracts that are settled in cash based on the price of the futures contract on the last trading day, in contrast to those that specify the delivery of a commodity or financial instrument.

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.

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 Service Provider - An entity 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.

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.

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 equity indexes, to name a few.

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

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.

Contract Month - A specific month in which delivery may take place under the terms of a futures contract. Also known as the delivery month.

Customer Margin - Within the futures industry, financial guarantees required of both buyers and sellers of futures contracts and sellers of options contracts to ensure fulfillment 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. Trading limits are usually removed when a contract begins the delivery process.

Day Traders - Speculators who take positions in futures or options contracts and liquidate them prior to 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. 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.

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. An increase in the demand for a commodity usually has a

positive impact on prices. Conversely, a decrease in the demand for a commodity usually has a negative impact on prices. Note that supply and other market factors may counter the impact of a change in the demand.

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.

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.

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.

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

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.

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.

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.

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. Purchasing (Long) Hedge - Buying 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. Also referred to as a buying hedge.

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.

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.

Introducing Broker (IB) - 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.

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)

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.

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.

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

Low - The lowest price of the day (or any specified time period) for a particular futures contract.

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

Managed Futures - Represents an industry comprised of professional money managers 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 level.

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.

Marking-to-Market - The process of debiting or crediting all margin accounts on a daily basis according to the settlement price of that day's trading session. In this way, buyers and sellers are protected against the possibility of contract default.

National Futures Association (NFA) - An industrywide, industry-supported, self-regulatory organization for futures and options markets. The primary responsibilities of the NFA are to enforce ethical standards and customer protection rules, screen futures professionals 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.

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 Auction (outcry) - Method of trading or type of trading platform for making verbal bids and offers in the trading pits or rings of futures exchanges.

Opening Range - A range of prices at which buy and 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 buyers pay the premium.

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 option buyer exercises their right under the option contract. Also referred to as the writer. Option sellers collect the option premium.

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.

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 initial margin.

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.

Position - A market commitment. A buyer of a futures contract is said to have a long position, which is an obligation to accept delivery and, conversely, a seller of futures contracts is said to have a short position, which is an obligation to make delivery.

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 Board of Trade Clearing Corporation 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.

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.

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

Purchase and Sell Statement - A Statement sent by a commission house to a customer when his futures or options on futures position has 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.

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.

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

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

Settlement price or Settle - Usually, the settle is the closing price or the simple average of the closing range 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. Also referred to as settlement price.

Short - One who has sold futures contracts or plans to purchase a cash commodity. Selling a futures contracts.

Speculator - A market participant who tries to profit from buying and selling futures and/or 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.

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 price. An increase in the supply of a commodity usually has a negative impact on prices. Conversely, a decrease in the supply of a commodity usually has a positive impact on prices. Note that demand and other market factors may counter the impact of a change in the supply.

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.

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.

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

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.

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.



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