## Appendix A

### *Glossary of Terms*

At-the-Money:

A term used to describe a put or call option with a strike price that is equal to the current market price of the underlying futures contract. An at-the-money option has no intrinsic value, so the entire premium represents time value.

Basis:

The difference between the cash price and the futures price (the local cash price minus the futures price). The outcome of all futures and options based marketing strategies is a combination of what happens to a cash position and a futures position. Thus, how the two markets behave relative to each other determines the actual price from hedging. Basis provides a single value that reflects this relative relationship between the two markets. In a broader sense, basis can measure the relationship between any two market prices. Therefore, the term is sometimes used to describe the relationship between two cash markets (for example, the local cash price and the Portland cash price).

Basis Risk:

The risk associated with not being able to predict the basis accurately. The outcome of a hedged position is determined by the actual basis relative to the expected basis. Thus, the accuracy of the basis prediction (expected basis) determines the actual hedge price relative to the expected hedge price. Basis risk that is lower than the risk associated with a cash position is necessary for hedging to reduce price risk.

Broker:

An agent that conducts or arranges for actual futures and options trades per a customer's instructions. The broker is represented by a firm that has access to the trading floor, and charges a commission for this service.

Call Option:

The right (but not the obligation) to buy a specified futures contract at a stated price on or before a designated date.

Cash Market:

A market which focuses on buying and selling the physical commodity for immediate or near term delivery. Since the focus of a cash market is the actual commodity, your commodity will actually be delivered and sold to a cash market.

Commission:

The fee charged by the broker for conducting futures and options trades on your behalf. Such fees vary widely, and generally depend on trading volume and the additional services provided by the brokerage firm.

**Commodity Option:**
The right (but not the obligation) to a specified commodity futures contract position at a stated price during a designated time period. An option can either be the right to a short futures position (a put) or the right to a long futures position (a call).

**Contract Month:**
The calendar month when a futures contract matures (also called the delivery month). The contract month establishes a time frame for potential delivery of the commodity (which influences the value of the contract) and determines the last trading day of the futures contract.

**Exercising an Option:**
The processs used by the holder of an option to convert the right to a specified futures position at a stated price into an actual futures position.

**Exercise Price:**
See Strike Price.

**Expiration Date:**
The date when the option holder loses the right to exercise the option. The expiration date for commodity options is determined by the contract month of the underlying futures contract. Expiration dates vary, but for grains the date usually occurs sometime late in the month just prior to the contract month of the underlying futures contract.

**Extrinsic Value:**
See Time Value.

**Futures Contract:**
A transferable and legally binding agreement whereby the seller agrees to deliver and the buyer agrees to accept delivery of a standardized amount and quality of a commodity at a specified location during a designated time period. The obligation created by the sale or purchase of a futures contract can be fulfilled in two ways. A seller can offset the promise by taking the opposite position (a buy) on the same futures contract, or deliver the commodity per the agreement. A buyer can offset the promise by taking the opposite position (a sell) on the same futures contract, or accept delivery of the commodity per the agreement.

**Grantor:**
See Writer.

**Hedging:**
The practice of offsetting price risk associated with the cash market by simultaneously holding an offsetting position in the futures market.

**Hedging Costs:**

Transaction costs associated with being involved in the futures market as a result of hedging or trading options. These generally include broker's commissions and the interest cost associated with having money deposited in your margin account. Although hedging costs vary depending on commissions, interest rates, and the period of time you maintain a futures or option position, hedging costs are generally about 1 to 4 cents per bushel.

**Holder:**

The buyer (or owner) of a commodity option. The holder has the right (but not the obligation) to enter into the specified futures position at the stated (strike) price.

**In-the-Money:**

A commodity option that has value if exercised immediately. A put is in-the-money if its strike price is above the current market price of the underlying futures contract. A call is in-the-money if its strike price is below the current market price of the underlying futures contract.

**Initial Margin:**

The initial deposit necessary to open a long or short futures position. See Margin.

**Intrinsic Value:**

The value of a commodity option if immediately exercised. Intrinsic value for an in-the-money put is equal to the strike price minus the current market price of the underlying futures contract. Intrinsic value for an in-the-money call is equal to the current market price of the underlying futures contract minus the strike price. At-the-money and out-of-the-money options have no intrinsic value.

**Long Position:**

The designation given to a situation where one has purchased a futures contract. An individual in a long position has an obligation to offset the long position with the sale of the same futures contract, or accept delivery of the commodity.

**Maintenance Margin:**

The minimum amount of money per contract that must be kept on deposit as losses occur. See Margin.

**Margin:**

Money deposited by buyers and sellers of futures contracts and sellers of options to ensure performance. The initial margin is the amount that must be deposited at the time an order to buy or sell a futures contract or sell an option is placed. If losses occur, the initial margin is reduced by the amount of the loss. When the initial margin less the loss reaches a minimum level (maintenance margin), a margin call is triggered and additional money must be deposited to keep the position.

**Margin Call:**
A call from a broker for additional funds to bring the margin up to some minimum level. See Margin.

**Nearby Futures Contract:**
The futures contract month with a maturity closest to the current date or closest to some other specified date.

**Offset:**
The commonly used mechanism for eliminating a futures position by taking an opposite position in the same futures contract. A short position (sold a futures contract) can be offset with a long (buying the same futures contract). Conversely, a long position (bought a futures contract) can be offset with a short (selling the same futures contract).

**Option:**
See Commodity Option.

**Out-of-the-Money:**
A commodity option that has no value if exercised immediately. A put is out-of-the-money if its strike price is below the current market price of the underlying futures contract. A call is out-of-the-money if its strike price is above the current market price of the underlying futures contract.

**Premium:**
The market price (or value) of the option, which is determined by the sum of intrinsic and time value. Grain option premiums are quoted in cents per bushel.

**Price Risk:**
The risk associated with an unexpected and unfavorable change in the cash market price.

**Put:**
The right (but not the obligation) to sell a specified futures contract at a stated price on or before a designated date.

**Round Turn:**
The process of entering the futures market with a long or short position and then offsetting your position with an opposite transaction. For futures contracts, brokers commissions are quoted per contract for a round turn.

**Seat:**
A position on an exchange that gives the holder the right to conduct actual trades on the trading floor. The number of seats is limited and owners can sell the seat to someone else.

**Short Position:**
The designation given to a situation where one has sold a futures contract. An individual in a short position has an obligation to offset the short position with a buy on the same futures contract, or deliver the commodity.

**Speculating:**
Buying and selling futures or options contracts for the purpose of earning a profit by correctly anticipating commodity price changes. Speculating in commodity futures and options is generally considered a high risk investment strategy. Speculation occurs whenever a futures/options position is maintained without an offsetting position in the cash market.

**Strengthening Basis:**
Occurs when the basis is getting larger. Since basis can be a positive or negative number, a stregthening basis means larger positive number or a smaller negative number. Basis gets stronger whenever the cash price increases relative to the futures price.

**Strike Price:**
The price at which the holder of a commodity option has the right to enter into the specified futures position should the holder choose to exercise (also called the exercise price or striking price). The holder of a put has the right to a short futures position at the strike price. The holder of a call has the right to a long futures position at the strike price.

**Time Value:**
The amount buyers are willing to pay for an option in anticipation that a change in the price of the underlying futures contract over time will bring about an increase in the option's value (also called extrinsic value). The premium (which represents the option's market value) is composed of time value and intrinsic value. Thus, the amount by which the premium exceeds the option's intrinsic value represents time value. For at-the-money and out-of-the-money options (which have no intrinsic value), the entire premium represents time value.

**Trading Pit:**
An area of the exchange's trading floor where the actual trading of a specific futures contract or option takes place.

**Weakening Basis:**
Occurs when the basis is getting smaller. Since basis can be a positive or negative number, a weakening basis means a smaller positive number or a larger negative number. Basis gets weaker whenever the cash price decreases relative to the futures price.

**Writer:**
The seller of an option (also called the grantor). For a put, the writer has the obligation (but not the right) to give the option holder a short position on the underlying futures contract at the strike price. For a call, the writer has the obligation (but not the right) to give the option holder a long position on the underlying futures contract at the strike price.

**Underlying Futures Contract:**
The specific futures contract that the option conveys the right to sell (for a put) or buy (for a call).

## Appendix B

***Table 1. Grain Futures Contracts Currently Traded on US Exchanges***

| Exchange | Commodity | Contract Quantity | Contract Months |
|---|---|---|---|
| Chicago Board of Trade (CBT) | Corn | 5000 bu. | Mar, May, Jul, Sep, Dec |
| Chicago Board of Trade (CBT) | Wheat (soft red winter) | 5000 bu. | Mar, May, Jul, Sep, Dec |
| Chicago Board of Trade (CBT) | Oats | 5000 bu. | Mar, May, Jul, Sep, Dec |
| Kansas City Board of Trade (KC) | Wheat (hard red winter) | 5000 bu. | Mar, May, Jul, Sep, Dec |
| Minneapolis Grain Exchange (MPLS) | Wheat (hard red spring) | 5000 bu. | Mar, May, Jul, Sep, Dec |
| Minneapolis Grain Exchange (MPLS) | Wheat (soft white) | 5000 bu. | Mar, May, Jul, Sep, Dec |
| MidAmerica Commodity Exch. (MCE) | Corn | 1000 bu. | Mar, May, Jul, Sep, Dec |
| MidAmerica Commodity Exch. (MCE) | Oats | 1000 bu. | Mar, May, Jul, Sep, Dec |
| MidAmerica Commodity Exch. (MCE) | Wheat (soft red winter) | 1000 bu. | Mar, May, Jul, Sep, Dec |

Note: Put and call options with a variety of strike prices are available for most of the listed futures contracts.