Why do so many people lose money in commodity options?

Presented by: T & K Futures and Options Inc.

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Forward

The author of this manual is a series 3 registered commodity broker who has been trading the commodity markets for over a decade. He has seen most commodity option buyers lose money and wanted to try to make commodity option investors more savvy and aware of the mechanics and strategies that may decrease the number of losing option trades that occur in small commodity speculators' portfolios.

This booklet should be used as an abbreviated version of the huge encyclopedia type volume that it would take to explain all of the parts of the commodity markets. The focus of this manual is options because so many small speculators trade options to avoid the fear of the huge losses that can occur in the futures markets, margin calls, but lose their money anyways.

Hopefully, this manual will teach you at least one thing that you did not know before you downloaded it. It has been said that knowledge is priceless and if that one thing makes you money or saves you from losing money- then this manual has done its job. This book is written in a very simple and straight forward style to cater to the maximum number of readers. Complex strategies and ideas are broken down into their simplest form for easy learning and only the most practical strategies are explained. This manual in no way should be considered as a guarantee that your trading results will improve.

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The Story Behind the Financial Integrity of the U.S. Futures Markets

The following information is from the National Futures Association. They are one of the organizations who watch over the futures markets and its participants to ensure the integrity of the markets. Trading volume in futures contracts and options on futures on U.S. markets has risen to more than 500 million contracts annually. And the dollar value of futures contracts traded currently exceeds the dollar value of common stocks traded on all U.S. stock exchanges by a large margin.

A requisite for this growth has been the financial integrity of futures markets. While trading in futures contracts obviously involves risks related to price changes, market participants have historically had little reason to be concerned about the security of their funds. *Customer losses due to the insolvency of a futures brokerage firm have been virtually non-existent. Indeed, such losses have totaled less over 50 years than the Securities Investor Protection Corporation has paid, on the average, to reimburse customers of the securities industry for member firm insolvency losses each year.*

For anyone considering participation in the nation's futures markets, the reasons behind this continuing and impressive record of financial soundness are worth knowing about.

Daily Cash Settlement

As futures prices move upward and downward, the market value of customers' open positions increases and decreases. Resulting gains and losses from futures trading are credited or charged to each customer's account each day following the close of trading. Subject to existing margin requirements, all gains deposited to a customer's account through this procedure become immediately available to the customer.

Margin Requirements

Buyers and sellers of futures contracts are required to at all times maintain sufficient funds on deposit in their brokerage accounts to cover losses that might be incurred as a result of price changes. Margin deposits provide protection for all market participants. In volatile markets, the exchanges increase margin requirements accordingly. The availability of such funds is what makes daily cash settlements possible under all market conditions.

The Exchange Clearing Houses

Once each purchase of a futures contract is precisely matched to the corresponding sale (a process which occurs each day), the clearing organization of the exchange where the contracts are traded becomes the "buyer to every seller and the seller to every buyer." The purpose: provide a mechanism that assures the payment of all gains and collection of all losses on a daily basis.

Capital Requirements

Every firm that conducts business with the public as a Futures Commission Merchant must have and maintain sufficient capital to meet its financial obligations to its customers. These requirements are subject to continuous audit and stringent enforcement. Regulatory agencies have the authority to determine compliance on a daily basis and in volatile markets clearing organization can demand that a firm provide additional capital on one hour's notice!

Segregated Accounts

Firms and principals of firms in the futures industry are required to maintain their customers' funds

and margin deposits in bank accounts which are totally separate from their own. Rules further stipulate that such funds can be used only for the purposes the customers intended and can at no time be commingled with the firm's funds or the funds of the firm's principals. Compliance is strictly enforced and regulators possess power to take such immediate action as is considered necessary to protect the security of customers' money.

Transfer of Market Positions

Should a firm be determined to be in a financial situation that could potentially jeopardize the safety of its customers' funds, it can be directed to immediately cease operations and transfer all open customer positions in the market to a firm which is financially sound. This is to ensure that adequately margined positions with a troubled firm will not be liquidated at a time when the customer may not wish for them to be liquidated.

Regulation

Regulation of the U.S. futures industry is primarily self-regulation, with the role of the federal Commodity Futures Trading Commission being principally an oversight role (to determine that self-regulation is continuous and effective). Of the total expenditures on futures regulation, more than three-fifths of the cost is presently being paid by the exchanges where futures contracts are traded and by National Futures Association (NFA), the industry-wide self-regulatory organization authorized by Congress and established in 1982. The purpose of self-regulation is to assure that those who conduct futures trading business with the public do so in a professional, ethical and honest manner.

NFA's responsibilities include screening, testing and registering persons applying to conduct business in the futures industry. NFA and the exchanges have responsibility for auditing and enforcing compliance with industry rules. These rules encompass financial requirements, segregation of customers' funds, accounting procedures, sales activities and, in the case of the exchanges, floor trading practices.

Although there is no guarantee against customer losses due to the insolvency of a futures brokerage firm, the above mechanisms are designed to ensure the financial integrity of this nation's futures markets, and have in fact minimized the risk of customer losses.

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When did the commodity markets get started?

The futures markets have been traced back to the trading of rice futures in the 1700's in Osaka, Japan. Many historians, however, believe that the early shipping companies around Persia had futures pricing techniques and risk transference procedures for the promise of their shipped goods such as olive oil, spices and various other goods before Christ.

In the United States of America, the first futures contracts were corn and cotton. Corn futures were traded in Chicago and cotton was traded in New York and both began at approximately the same time about 150 years ago. Today there are many different futures contracts and the commodity markets' money flows dwarf the stock markets on a daily basis.

Why do we need commodities in the first place?

To understand the importance of the futures markets one must envision an agricultural society that is dependent upon farming for its survival. During harvest times the abundance of the product is so high versus the demand that the farmer is practically giving it away and much of the product goes bad and is wasted. Out of harvest the product's supply is low versus the demand so the prices become exorbitant. These huge swings in price affect the producer as well and the consumer. Before the industrial revolution, the cash markets could handle the supply and demand. But with the new technologies came more efficient production and harvest of the crops and supply more than met the consumer demand. Now we needed futures pricing and better storage procedures.

The producer must be able to budget money for production, bank loan repayments, storage and distribution so a fixed pricing mechanism is very helpful to the farmers' success. The futures markets allow the producer to lock in the future price of the product before it is even planted in the case of agricultural products.

On the consumer side, the prices now did not have the huge price swings that occurred before the futures markets and therefore became more affordable to everyone.

Exchanges, Clearing Firms, FCMs, IBs, Brokers, NFA, CFTC

Many people often wonder how such a huge marketplace can run so efficiently especially if they have seen film of the exchange floors in full swing. Here is how that works: **the exchanges** are basically an auction house where traders, investors, companies…. Come to make money, hedge cash price risk, lock in prices for a product for future delivery, lock in prices for a future sale of a product…. The exchanges provide set contract specifications including trading hours, contract size, contract quality, trading months, minimum margin requirements, and guarantee every transaction that takes place on their exchange.

The clearing firms are separate and independent from the exchanges. The clearing firm acts as a guarantor to every contract, acting as a buyer for every seller and a seller for every buyer. The clearing firm is the payment and collection agency for its members and through them their customers.

FCM's are futures commission merchants ie. individuals, associations, partnerships, corporations and trusts that solicit or accept orders for the purchase or sale of futures and options on futures and that accept payment from or extend credit to those whose orders are accepted. FCM's must be registered with the National Futures Association.

IB's are any person, other than someone registered as an associated person of a futures commission merchant, who solicits or accepts futures and related options orders but does not accept money from customers.

Commodity brokers are series 3 federally licensed associated persons who solicit business for the Introducing broker who has sponsored them.

NFA ie. the National Futures Association are the watchdogs of the futures industry. They were formed in 1976 by the Commodity Exchange Act and serve to regulate the participants in the futures industry. Their main purpose is to monitor and enforce rules that protect investors and make the system run more effectively. ALWAYS check up on the Broker and the Introducing Broker you are contemplating investing with before opening your account. Go to www.nfa.futures.or/basicnet/ to do so.

CFTC ie the Commodity Future Trading Commission is the federal regulatory agency used to enforce the codes of the Commodity Trading Act.

Why do so many people lose money buying put and call options?

First what are a put and a call option? A put is the right but not the obligation to sell an underlying commodity at a particular strike price for a specified period of time or enter a short futures position. If you buy a put you are betting on lower prices. A call is the right but not the obligation to buy an underlying commodity at a particular strike price for a specified period of time or enter a long futures position. If you buy a call you are betting on higher prices.

There is no one right answer to this "so many people losing money in options question". The markets are often very volatile which brings with it opportunity and proportionate risk. I believe that psychology plays a large part in the winning and losing process as well. People hate to lose and usually hold onto their losing trades instead of cutting losses and moving on. It's that whole hope springs eternal thing. The other side of the equation is people love to win. It's fun to say you made money in the markets. It makes you feel smart, lucky or whatever. Because of this many investors take their profits too quickly. If most of the trades are losers it makes mathematical sense that you better maximize your winners and minimize your losers or you will be out of money before you know it.

I believe that the two greatest enemies to option buying investors, besides themselves, are time decay and volatility premium. It amazes me that many people have never heard of these key components of option value. Options are by their very nature a wasting asset. Given a flat market scenario, they lose premium value daily. The only way for an option purchaser to make money is for the value of the option premium to increase more relative to the time decay of that option.

What is volatility premium?

When you buy and option (call/put), you are buying the right to buy or sell from an option grantor. They collect the premium that you pay for the option. They hope that you lose because if that happens they win. This is the whole zero sum investment thing you have heard about. The option grantor takes on the lion's share of the financial risk because while you are only liable for the premium that you paid for the option they are liable for the value of the contract. So they increase the price of the option premium to offset their risk relative the volatility of the market. The more price movement in the futures market where you purchased an option, the more volatility risk the grantor is taking. In other words, your chances to reach your strike price objectives are more attainable so the grantor charges more.

What if I want to play in one of those high volatility markets?

Well you will pay more premium and hope it everything works out or you use a strategy that takes advantage of the high volatility premiums.

Bull Call Spreads- purchase an option near the current futures price and offset that cost by granting one further out. This strategy is used in high volatility markets when you are betting on higher prices.

But isn't there more risk when you grant versus purchase?

Yes but in this case you are covered by the option that you purchased. It's like buying covered calls against stock that you already own. You might have to give up your stock but your risk is limited to that. In commodities your best case scenario using a bull call spread is the difference between the strike price minus your total costs. The worst case scenario is that you lose your investment. You are an option grantor and a purchaser in this case.

Bear put spreads work the same way except they use puts and are betting on lower prices instead of higher ones.

There are many other option investment strategies that you can use but I come from the keep it simple stupid camp. In low volatility premium times, I buy calls and puts. In high volatility times, I tend to use bull call and bear put spreads.

Example of a Bull Call Spread- buy 1 March Crude oil $70 call for $3000 and grant(sell) 1 March Crude oil $75 call for $1000. Total cost is $2000 plus commissions and whatever fees. Your total risk is whatever total you paid. Total profit potential is the difference between the strike price minus your total costs. ie. $5=$5000 minus your total costs. Here is the math- crude oil is a 1000 barrel contract=1000 barrels multiplied by $1 = $1000 times $5 = $5000.

Bear put spread is the same but with puts and you are betting on lower prices.

The bottom line is: during high volatility premiums consider using a bull call or bear put spread. During low volatility premiums use outright calls and puts.

Is there some way that I can hedge my bet?

Sure there is always a way to manage some of your risk in the commodities markets (that's basically what they are for in the first place). The easiest way to limit losses is to have a stop order that will offset your position at a certain price. Let's say you buy a $1000 call option and have a good till cancelled sell in at $500. That $500 is not a guarantee because I have seen stop orders get triggered way below the limit value but they usually work very well. As another example, let's say that you think crude oil is going higher and you have 10 call options for December and a $80 strike price. You think its probably going to $90 but you are worried about a decline because you remember $10 crude not to long ago. Decide what percentage of your bet you want to hedge and buy the appropriate number of similar quality puts in December. You must however keep in mind that the market can go sideways and your puts and calls will lose in that scenario.

Should I hedge my bet?

Only you know your risk tolerance and how much risk capital you should use. Let me play the devil's advocate and ask you, "Do you have car insurance, health insurance and insurance on your home"? Are you planning on getting in a car crash or getting sick or having something bad happen to your house? I doubt it but sometimes it's nice to hedge your risk just in case.

How much risk is there when buying options?

The answer is a lot. I believe that the official numbers are somewhere around 80 or 85 percent of options expire worthless. You have to keep in mind though that many huge corporations that need the commodity product use options to hedge against higher prices by buying calls or using long futures. In the case of the call option use, they hope they expire because that means the prices did not go up enough to really hurt their bottom line. If you are a producer of a product, you are

worried about getting less money for your product so you use puts or short futures (if you hedge your price risk) and once again expiring options is not necessarily a bad thing. It's like the premium that you pay for car insurance. It's just a waste of money unless something bad happens.

But the fact of the matter is that small speculators usually lose money when purchasing options and I believe there are many reasons for this. I think that most option buyers do not know what time decay and volatility premium are and how to fight these enemies of option buyers.

I also believe that most speculators enter the markets without enough capital to withstand losing trades. Let's face it with $5000 you can only get into maybe 2 or 3 different markets and maybe afford 6-10 options total. If 1 or 2 of those markets lose, you have a lot of ground to make up with just one market because all of your risk capital is already invested. Now if you had $50,000 and buy the same 6-10 options in 2 or 3 different markets you will have capital to add to the winners and diversify elsewhere etc.

I believe another reason why so many people lose in options is because they listen to the various news sources and base their trading on the so called experts. You have to understand that something like gold prices being at $260/ounce is not a good story. Who cares? But when gold is at $700/ounce and a 20 year high, everybody wants to talk about it. Now the "experts" say, "Gold is going to $1000/ ounce". "You better buy it before it goes any higher". Isn't the idea to buy low and sell high? It was like pulling teeth to get someone to buy gold at $260/ounce but the phone was ringing off the hook at $700/ounce. When do you think most of the small speculators decided it was time to buy gold? Yes, right near the 20 year top. If you don't believe me go back and visit the volume and open interest records at the top of almost every commodity and stock market run. There is even an indicator called bullish consensus that states that you should sell any market where more than 75% of the small speculators are bullish and you should buy when less than 25% of small speculators are bearish. That's right, small speculators have such a bad track record that people use

it as a contrarian indicator. Warren Buffet, the second richest man in the world, says, "When everyone is brave, be afraid and when everyone is afraid, be brave". I'm tempted to listen to him since he made his money investing in out of favor companies and commodities. **Don't be part of the herd.**

Another risk factor is the huge bid/ask spreads that can occur in high volatility times or in illiquid markets. Many investors do not understand that this can cause a huge debit in your account the second that you put the trade on. I have seen $400-500 bid/ask spreads in options during volatile trading times and illiquid markets on a number of occasions. Let me explain what the bid/ask spread is. Just like a stock or bond purchase a commodity has a spread. The spread is how the traders or some third party gets paid. In a liquid stock it might be 25 cents a share for instance. So if you bought 1000 shares of xyz for $5.25 you paid $5250 for a stock that you can only sell for $5000 if you immediately offset that trade. It's only worth $5 but you paid $5.25. So in this example the bid/ask would have to go to $5.25/$5.50 for you to break even. Now factor in commissions and fees. Imagine now that you purchase a coffee call for $1000 and it is only worth $500. That is a $500 bid/ask spread. You are down $500 the second you buy the option. **ALWAYS FIND OUT THE BID/ASK SPREAD BEFORE YOU BUY!!!!!!**

What markets have liquid (fair) option markets?

You are going to have to look at the volume and open interest in the particular commodity and month that you are trading. Usually the more liquid the future contract = more liquid options. Visit www.tkfutures.com/education.htm

My favorites are (Chicago Board of Trade) **grain options** such as corn, soybeans and wheat. The grain markets open up at 10:30 a.m. EST and close at 2:15 EST. The contract size is 5000 bushels and therefore a 1 cent move in your option premium = $50.

If you like **energy options** try to stick with the (New York Mercantile Exchange) crude oil options because the distillates and natural gas have less volume and therefore can have horrible bid/ask spreads and huge premiums. If you do trade crude oil it opens up at 10:00 a.m. EST and closes at 2:30 EST. The contract size is 1000 barrels and therefore each 1 cent move in your option premium = $10. If you must trade the distillates they open up at 10:05 a.m. EST and close at 2:30 EST. The contract size is 42,000 gallons for both heating oil and Unleaded Gas and therefore each 1 cent move in your option premium = $420.

If you trade the **financial options** you will find the (Chicago Mercantile Exchange) Eurodollar is the most fair followed by the (Chicago Board of Trade) Treasury Bonds and Notes. The Eurodollar, Bonds and Note contracts open up at 8:20 a.m. EST and closes at 3:00 EST. The Eurodollar contract size is $1,000,000 but it is a 90 day instrument so ¼ of the contract size is $250,000 so each tick move in your option premium = $25. The bonds and the notes are $100,000 contract sizes and are traded in 1/64. Each tick = $15.625 in your option premium. Yes the financials are confusing so I will take it a step further. Take $15.625 multiply it by 64= $1000 or a 1 basis point move.

The (New York Mercantile Exchange) **metals options** can be tricky but gold can be fair at times followed by silver and copper. Gold opens at 8:20 a.m. EST and closes at 1:30 EST. The contract size is 100 ounces therefore a $1 move in your option premium = $100. Silver opens at 8:25

a.m. EST and closes at 1:25 EST. The silver contract size is 5000 ounces and therefore each 1 cent move in your option premium = $50. Copper opens at 8:10 a.m. EST and closes at 1:00 EST. The copper contract is 25,000 pounds and therefore each 1 cent move in your option premium= $250.

The (New York Board of Trade) **food and fiber options** such as cocoa, coffee, sugar, cotton and orange juice are tough to trade. There can be decent volume and low volatility at times but watch yourself. Cocoa opens up at 8:00 a.m. EST and closes at 11:50 a.m. EST. The cocoa contract is 10 million metric tons and therefore each $1 move in your option premium is $10. Coffee opens up at 9:15 a.m. EST and closes at 12:30 EST. The coffee contract is 37,500 pounds therefore each 1 cent move in your option premium = $375. The sugar opens up at 9:00 a.m. EST and closes at 12:00 EST. The sugar contract is 11,200 pounds therefore a 1 cent move in your option premium = $1120. Cotton opens at 10:30 a.m. EST and closes at 2:15 EST. The cotton contract is 50,000 pounds therefore each 1 cent move in your option premium = $500. The orange juice contract is 15,000 pounds and therefore each 1 cent move in your option premium = $150.

The (Chicago Mercantile Exchange) **meat options** don't get a lot of attention but you can sometimes trade live cattle and feeder cattle without too much slippage. Feeder cattle and live cattle open at 10:05 a.m. EST and close at 2:00 EST. The live cattle contract is 40,000 pounds and therefore each 1 cent move in your option premium = $400. The feeder cattle contract is 50,000 pounds and therefore each 1 cent move in your option premium = $500. **The lesson is to trade active markets.**

What type of option strategies should I use?

My advice is to keep it simple. If the futures market you are interested in buying or selling is trading in a tight price range, buying calls and puts will probably be the way to go. If it is a high volatility futures market with large price ranges, a bull call spread or a bear put spread (mentioned earlier) will probably work best. Visit www.tkfutures.com/startegies.com

Are there any trading actions that are usually just bad ideas?

It is a bad idea to send a market order into any illiquid or extremely volatile market. Even if you have real time quotes keep in mind that market tickets are "supposed" to be filled within 3 minutes. I've seen $500- 800 ticks in crude during the first few seconds after a surprising outcome from a Department of Energy report. My point is a lot can happen in 3 minutes. **Use limit orders when it's crazy on the floor.**

Trading based on seasonal patterns is one of those things that looks real good on paper but very rarely works. The reason is that those patterns can make a certain up or down move during a certain time but what most people do not realize is the huge draw downs in your account value during the time frame can occur. Let's say coffee has gone up by an average of $1000 between May 1 and July 1 for the last 15 years in a row. Sounds good but the market might go down by $3000 on average to get the $1000 up move. In other words, there is a $4000 average price range from low to high so your average risk is 3 times your average potential profit. Your option is a wasting asset and can get killed during the down move and if you are in the futures you had better have plenty of margin money on hand.

It's a real bad idea not to check up on the commodity company and the broker that you are speaking to before opening an account and sending money in. **ALWAYS CHECK ON THE COMPANY AND THE BROKER BEFORE OPENING AN ACCOUNT**. It's real easy just go to

www.nfa.futures.org and it takes about 3 minutes. The regulators do an excellent job in ensuring the integrity of the markets and its participants. As a potential investor it makes sense to make sure you are sending your hard earned money to a legitimate and licensed commodity trading company, right?

How is the value of an option figured out?

First you have to understand the meaning of intrinsic and extrinsic value. The option premium is made up of both of these values. Intrinsic value is the value of the option if you exercised it to the futures contract and then offset it. For example you have a $5 November soybean call and November soybeans are at $5.20. Soybeans are a 5000 bushel contract so 20 cents multiplied by 5000 = $1000. That is the intrinsic value of the option.

Let's say that the $5 bean option mentioned above costs $1600 in premium. The other $600 is the extrinsic value. For instance how much time is left on that option? An option with 30 days left until expiration has less time value than the same option with 60 days. Time is money because the more time available to the option buyer, the more time they have for something positive to happen and consequently the option has more value.

Another extrinsic value is volatility premium. We have already covered that so just remember that the more the price moves from its highs to its lows, the more volatility premium is added to the option.

Another extrinsic value is option demand. If a lot of other option traders think that your particular strike price will become valuable and therefore they buy a whole bunch of them, this can lead to higher premiums for that particular strike price. Visit www.tkfutures.com/basics.htm to learn more.

How much will my option move relative to the underlying futures market?

It is very important to understand what the delta factor of an option is. Delta means change and that is what the delta factor tells you about the particular option that you are looking at. Let's say you are interested in buying December gold call options because you think that the price of gold is going up by $50/ounce=$5000 a futures contract before the expiration of that contract. Let's say you bought an option with a .20 or 20% delta factor. This means that your option should gain approximately $1000 of the $5000 move if it occurs. Now you must figure in the total cost of that option and decide if the risk vs. the expected profit is worth it or not.

Many hedgers use the option markets as insurance for price risk. It would take 5 of the .20 delta options to offset 1 futures contract because .20 multiplied by 5 = 1. Hedgers that use options figure out how much or what percentage of "price insurance" they want and then they buy the appropriate number of options to achieve that goal. Visit www.tkfutures.com/basics.htm to learn more.

What are the various types of accounts available to commodity investors?

You pretty much have 4 choices of account types:

#1 is a full service account. A full service account is where a professional commodity broker suggests trades for your account, monitors your account, services your account and lets you know if it's time to cut losses or lock in profits on a particular trade. These are non discretionary which means that the broker will not buy or sell at their own discretion or without your approval. Commissions are usually highest for full service accounts. Check the commission schedule before trading www.tkfutures.com/commission.htm . This type of account is for investors that want to

participate in commodities but do not want to trade based on their own research and opinions. Visit www.tkfutures.com/commodity_broker.htm to learn more about how to choose.

#2 is a broker assisted account. This type of account is for an investor that knows what they want to trade but wants to call it into a broker to place the trade just so there are no order mistakes. Order errors can be costly. This type of service also allows for brief conversations such as what is the bid/ask and last trade on the option? Do you think this price will get filled? You get the idea. This account is the happy median between full service and discount accounts.

#3 is the discount online account. This account is for investors who do their own research and simply need a conduit for their trades. These investors are uninterested in the opinion of a broker and require little or no contact and therefore pay the least commissions per trade.

#4 is the managed account. This account is a discretionary one where a power of attorney is needed. A commodity trading advisor trades these accounts and they work in a similar way to a mutual fund. The commissions are usually fee based instead of transactional in nature. These accounts typically require at least $25,000 of start up money to begin.

Pre-investment account checklist

1) Check up on the company and broker you are considering.
2) Figure out what type of service is best for you.
3) Are you sufficiently capitalized to trade?
4) Are you using risk capital?
5) Do high risk investments compliment your investment goals and your personality?
6) If steps 1-5 have been accomplished now it is time to open and fund your commodity option account. Go to www.tkfutures.com/open_account.htm and begin trading today.

Feel free to pass on this informative Ebook to your friends or anyone else that you think may be interested in commodity option investing.

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Glossary of useful option terms

At the money: an option whose strike price is equal or approximately equal to the price of the underlying futures contract.

Call option: and option that gives the option buyer the right but not the obligation to buy the underlying futures contract at the strike price on or before its expiration date.

Closing transaction: A buy or sell that liquidates (offsets) an existing option. That is selling, an option that was previously purchased or buying back an option which was previously sold.

Delta: the amount by which an option's price will change for a unit change in the underlying futures market price.

Exercise: the action taken by the options holder if he wishes to buy (call) or sell (put) the underlying futures contract.

Expiration: the date after which an option may no longer be exercised.

Futures contract: a contract that is traded on a futures exchange for the delivery of a specified commodity of financial instrument at a future time. This contract specifies the item to be delivered and the terms and conditions of delivery.

Futures price: the price of a particular futures contract determined by open competition between buyers and sellers on the trading floor or platform of the exchange.

Hedge: the buying or selling of offsetting positions in order to provide protection from adverse price changes.

In the money: An option is in the money when it has intrinsic value. A $3 December corn call is in the money if December corn futures are higher than $3. A $3 December corn put is in the money if December corn futures are lower than $3.

Intrinsic value: This is the dollar amount that can be gained if the option was exercised or offset.

Out of the money: An option is out of the money when it has no intrinsic value. A $3 December corn call is out of the money if the December corn futures are $2.99 or less. The reverse is true for a put option.

Premium: Premium is the price of the option not including commissions and any other fees.

Put option: A put option is the right but not the obligation to sell underlying futures contract on or before it expires.

Strike price: The strike price is the price where the holder of the call or put can exercise their right to buy or sell the underlying futures contract.

Risk Disclosure

Futures, options and managed future trading may be the riskiest of all federally regulated investments. Speculators who trade futures and options should only do so with risk capital. Past performance is not indicative of future results. There are no guaranteed good trades. The use of stop orders does not guarantee or necessarily limit losses to intended limits. Futures trading and option granting involve unlimited risk. When purchasing options on a futures contract, the investor is at risk for the premium paid plus commissions and fees. Options, cash and futures markets are separate and do not necessarily respond in the same way to similar market stimuli.

Always understand your worst case risk scenario before entering into any options or a futures trade. Future risk, commodity risk, commodity risk management are very important factors to consider before doing any type of investment speculation. All speculative investments carry a higher degree of risk than non speculative investments.

Statements, facts, quotes, data and information contained herein are gathered from various sources that are believed to be reliable. T & K Futures and Options Inc. cannot guarantee its accuracy, timeliness or completeness. No responsibility is assumed with respect to any such statements, facts, quotes, data and information.

The statements above are to point out the inherent risks involved in legitimate, federally regulated investments such as trading futures contracts and options on a futures contract.

Contact Us Today For More Information!

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