MARKETING TERMINOLOGY

Paul E. Patterson

A.E. Extension Series No. 89-2

October 2, 1989

MARKETING TERMINOLOGY

by
Paul Patterson

-A-

AT-THE-MONEY. An option whose strike price is either equal to or approximately equal to the current price of the underlying futures contract.

-B-

BAR CHART. The most popular technical tool whereby the price range each day (week, month or year) is represented by a single vertical bar on a chart. The bottom of the bar represents the low price, whereas the top of the bar represents the high price for the time period. A tick mark on the left side of the bar represents the opening price, while a mark on the right indicates the closing or settlement price. The trader will then watch the bar chart for particular patterns, which he/she believes are recurring to determine a strategy.

BASIS. The difference between the current cash price for a given commodity at a specific location and the futures price. Basis is normally computed as local cash price minus nearby futures price. If basis is quoted as over or under, it refers to the cash price being over or under the futures price, respectively.

BASIS CONTRACT. A marketing alternative whereby the producer delivers grain to the elevator and agrees to establish the price of the grain sold before a specified date. Price is tied to a predetermined basis. A producer using this marketing alternative extends his or her marketing year and has eliminated basis risk but still has price risk. Partial payment for the grain is often received at the time of delivery and storage charges are often waived. In the event the elevator should declare bankruptcy, the producer becomes an unsecured creditor.

BASIS RISK. The risk associated with not being able to predict basis accurately. Because of arbitration between the cash and futures markets, basis risk is less than price risk.

BILATERAL AGREEMENTS. Agreements between exporting and importing countries to buy or sell a certain amount of grain each year.

BEAR. A person who thinks prices will fall. Also, a market where prices are falling and future decreases are anticipated.

BROKER. An agent who executes transactions for a commission or fee. (Also see FLOOR BROKER.)

BUFFER STOCKS. Grain stocks available for use to reduce grain price fluctuations.

BULL. A person who thinks prices will rise. Also, a market where prices are rising and future increases are anticipated.

BUY (OR SELL) ON CLOSE ORDER. A marketing order which a trader gives a broker to buy or sell within the closing price range.

BUY (OR SELL) ON OPENING ORDER. A marketing order which a trader gives a broker to buy or sell within the opening price range.

-C-

CALL OPTION. An option which gives the buyer (holder) the right, but not the obligation, to purchase the underlying futures contract at the strike price on or before the expiration date.

CANADIAN WHEAT BOARD. A Canadian government agency which has exclusive power regarding export and domestic sales (for human consumption) for wheat, barley and oats.

CARRYING CHARGES. The expenses involved in owning the cash grain. Major components include storage, insurance and interests costs. In a normal market, price differences for future contract months will reflect these charges.

CARRYING CHARGE MARKET. A situation in the cash or futures market where the price change from month to month reflects the carrying charges.

CASH FORWARD CONTRACT. A legal agreement to deliver a fixed quantity and grad of grain (or turn over ownership of grain in commercial storage), at a specified price to a designated location. The producer using this marketing alternative expands his or her marketing year and eliminates price risk but still has production risk.

CBOT. Chicago Board of Trade.

CERTIFIED STOCKS. Grain stocks approved as deliverable grades because they meet the grades specified in the futures contract. Also, they are stored in a facility approved by the exchange which trades the futures contract.

CHANGE. The difference in closing prices for a commodity of a futures contract from one day to the next.

C.I.F (COST, INSURANCE AND FREIGHT). An agreement whereby the seller pays for all costs, insurance and freight to the designated delivery point.

CLOSE. The last price at which a commodity or a futures contract is traded on a specified day.

COMMISSION. Fees paid to a broker for executing an order to buy or sell a futures or options contract.

COMMISSION HOUSE. A brokerage firm that buys and sells future contracts on commission for the accounts of customers.

COMMODITY FUTURES TRADING COMMISSION (CFTC). The federal agency which regulates futures and options trading.

CONSIGNMENT. A commodity placed under the control of an agent or broker for custody or sale.

CONTRACT GRADES. Grades and standards specified in the rules of an exchange, which must be met to deliver against the futures contract. In many instances, grain meeting different grades and/or standards can be delivered but at a premium or discount.

CONTRARY OPINION. A technical strategy which trades against prevailing market opinion. It assumes that the psychology of traders often exaggerates the incorporation of market news into the market.

CROP YEAR. The marketing and production year for individual crops designated by the United States Department of Agriculture.. For corn and soybeans, the marketing year begins September 1 and ends August 31 of the following year. For wheat, it begins on June 1 and ends on May 31 of the following year.

-D-

DAY ORDER. Instructions which a trader gives a broker that will expire at the end of the day if they are not executed.

DAY TRADER. A futures trader who initiates and closes his position on the same day.

DEFERRED PRICING CONTRACT. A marketing alternative whereby the producer delivers grain to the elevator, and agrees to establish the price of the grain sold before a specified date. Price is generally tied to the local bid price, and storage charges are often eliminated. The producer will often receive partial payment for the grain at the time of delivery. Should the elevator declare bankruptcy, the producer becomes an unsecured creditor. The grain producer still has price risk.

DELIVERY. Delivery refers to the changing of ownership or control of a commodity under the very specific terms and procedures established by the exchange where the contract is traded. Delivery points and methods vary from contract to contract.

DELIVERY MONTH. This is the specified month within which delivery may be made under the terms of a futures contract.

DISCOUNT. This is the downward price adjustment made when the commodity delivered against a futures contract does not meet the contract grade.

-E-

EXERCISE. To convert an option contract to a position in the futures market. The action taken by the buyer of a **put** if he wishes to sell the underlying futures contract, or by the buyer of a **call** if he wishes to buy the underlying contract.

EXPIRATION DATE. The last date on which the buyer of an option may exercise the option. Options expire on a specified date in the month previous to the delivery month for the underlying futures contract.

EXTRINSIC VALUE. Same as time value.

-F-

F.A.S. (FREE ALONGSIDE SHIP). An agreement whereby the seller delivers grain to a designated export facility, and the buyer pays for loading the ship and for ocean freight and insurance.

FIXED COSTS. Cost that do not change with the level of use. In storing grain, the costs of facility ownership such as depreciation, interest, taxes and insurance would be fixed. The costs do not change whether the storage bin is left empty or full.

F.O.B. (FREE ON BOARD). An agreement whereby the seller pays for lading the ship or other means of transportation at the designated point of delivery, with the buyer paying freight charges.

FLOOR BROKER. The person who actually executes someone else's trading orders on the floor of the exchange.

FORMULA PRICING. Setting the price of a transaction to an agreed-upon formula associated with some future reported price.

FORWARD CONTRACT. Generally refers to any cash market transaction for which delivery is not made at the time of the agreement. The delivery time, place and other conditions are usually specified in the agreement. These are non-standardized in comparison with futures contracts.

FUNDAMENTALS. A term which refers to basic economic (actual or anticipate supply and demand) factors determining the price of a futures contract.

FUNDAMENTAL ANALYSIS. Analysis which utilizes supply and demand variables to predict a market price or basis.

FUTURES CONTRACT. A standardized contract, traded on a futures exchange, for the delivery of a specified commodity. The contract specifies the terms and conditions of delivery.

FUTURES PRICE. The price of a particular futures contract at a particular point in time. The price is determined by open competition between buyers and sellers on the floor of a futures exchange.

-G-

GOOD TILL CANCELLED ORDER. Instructions which a trader gives a broker, that remain in effect until the order is either executed or cancelled.

GRANTOR. The seller of an options contract.

-H-

HARVEST HEDGE. A hedge used for protection against adverse price movements until the grain is harvested.

HEDGE. Holding equal and opposite positions in the cash and futures markets (or options markets) to provide protection against an adverse change in price. The purchase or sale of the futures contract is taken as a temporary substitute for the actual purchase or sale of the commodity.

HEDGER. The market participant on one side of the futures transaction who owns the commodity or who will own the commodity in the future, including producers, elevators operators, processors and exporters. (See speculator.)

HIGH. The peak price at which a commodity or futures contract is traded for a specified day.

HOLDER. The buyer of an options contract.

-I-

IN-THE-MONEY. A call is in-the-money if it has intrinsic value. A put is in-the-money if it has intrinsic value.

INTRINSIC VALUE. For a put, the strike price minus the price of the underlying futures contract, if positive; otherwise, zero. For a call, the price of the underlying futures contract minus the strike price, if positive; otherwise, zero.

INVERTED MARKET. A situation where nearby futures contracts are selling at a premium to distant futures contracts. Hence, the carrying costs are not reflected in prices. This normally indicates that current supplies of the commodity are in short supply.

-K-

KCBT. The Kansas City Board of Trade.

-L-

LIFE OF CONTRACT. The period of time from the first to the last trading day for a particular futures contract.

LIMIT. The maximum price advance or decline allowed from the previous trading days settlement price for a specific futures contract under exchange rules. Limits can be modified by the exchange during highly volatile markets and they are removed during the end of the contract's life.

LIMIT ORDER. A customer's order to buy or sell a specified futures or options contract which sets a limit on either price or time of execution, or both. (See MARKET ORDER.)

LIQUID MARKET. A market where buying and selling takes place with comparative ease because of the large number of buyers and sellers.

LIQUIDATION. A purchase or sale which offsets an existing position in the futures or options markets.

LONG. The position established by the purchase of a futures or options contract if there is no offsetting position.

LONG HEDGE. A buying or long hedge is taken in anticipation of a later purchase in the cash market and is for protection against rising commodity prices.

LOW. The lowest price at which a commodity or futures contract is traded on a specified day.

-M-

MARGIN. In futures, money deposited by both buyers and sellers to ensure performance of the terms of the contract. This is not a downpayment on the commodity, only security deposit. The commodity exchanges establish minimum margin requirements, but individual brokerage houses may charge considerably more margin money than the minimums established by the exchanges. No margin money is required from buyers of option contracts.

MARGIN CALLS. Additional funds which a person with a futures position or the seller of an options contract may be called upon to deposit with the brokerage firm, if there is an adverse price change or if margin requirements are increased.

MARGIN, INITIAL. The amount of money required by a brokerage house to establish a futures position.

MARGIN, MAINTENANCE. The amount of money or equity that must be on deposit at all times to maintain a futures position. If the amount of equity in an account drops below the maintenance margin, the trader will receive a margin call equal to the difference between the initial margin requirement and the trader's equity. If the trade is unable to obtain sufficient funds to meet the margin call in a timely manner, then the futures position will be closed.

MARKET-IF-TOUCHED ORDER (ALSO BOARD ORDER). Instructions which a trader gives a broker to buy or sell a futures or options contract when price reaches a specified or better price. Upon reaching the specified price, the order automatically becomes a Market Order.

MARKET ORDER. Instructions which a trader gives a broker to buy or sell a futures contract at the best price available and as soon as possible, after the order reaches the trading floor of the exchange. (See LIMIT ORDER.)

MATURITY. The period of time in a futures contract's life in which the seller can make physical delivery, and the buyer can take physical delivery of the cash grain.

MID-AM. The Mid-America Commodity Exchange.

MGE. The Minneapolis Grain Exchange.

MOVING AVERAGES. A trend-following technical tool which uses moving averages to detect significant changes in the trend of the market.

-N-

NAKED WRITING. Selling (writing) an options contract with no opposite cash or futures market position. Also called uncovered writing.

NEARBY. The futures contract with maturity closest to the current date.

NOTICE DAY. The day on which a "notice of intention of delivery" can be issued for a specific futures contract.

NYCE. The New York Cotton Exchange.

-O-

OFFSETTING AN OPTION. This is the method by which holders of "in-the-money" option realize any profit and liquidate their position, not by exercising the option but by reselling the option to someone else.

OPEN. The price for the first trade on a commodity or futures contract for a given day.

OPEN ORDER. *See* Good Till Cancelled Order.

OPEN INTEREST. The total number of futures or options contracts outstanding on a given commodity or contract at a specific point in time. Most technicians will use commodity open interest rather than the open interest on an individual contract.

OPTION. The right but not the obligation to take a position in the futures market at a specified price. (See PUT OPTION and CALL OPTION.)

OUT-OF-THE-MONEY. A call option whose strike price is above the current futures price, or a put option whose strike price is below the current futures price (that is, the option contract has no intrinsic value).

OVERBOUGHT. A market condition in which prices have risen too fast and too far, relative to the underlying economic fundamental factors. Traders would expect prices to fall in this type of market, at least in the near term.

OVERSOLD. A market condition in which prices have fallen to fast and too far, relative to the underlying economic fundamental factors. Traders would expect prices to rise in this type of market, at least in the near term.

-P-

PINK GRADING CERTIFICATE. A certificate which attests to the accuracy of the grade of a particular sample of grain.

PIT. An area on the trading floor of a grain exchange where trading in futures is conducted.

POINT. The minimum price fluctuation allowed for a particular type of futures contract.

POINT AND FIGURE CHART. A charting technique which assumes that the only important thing is the direction of price change--volume and time are unimportant. Chart patterns are then observed to determine a trading strategy.

POSITION. A committed position in the market. (See LONG and SHORT.)

POSITION TRADER. A futures trader who has his futures position for an extended period of time.

PREMIUM. The price of an option, not including related brokerage commission fees. The buyer of an option pays the premium, whereas the seller of an option receives the premium. The premium is comprised of "intrinsic value" and "time value."

PREMIUM. This is the upward price adjustment made when the commodity delivered against a futures contract exceeds the contract grade.

PRICE RISK. The risk associated with not being able to predict price accurately. Price risk is greater than basis risk.

PRODUCTION RISK. The risk associated with a producer not being able to predict his/her production accurately.

PUBLIC LAW 480 (PL 480). The legal authority which the U.S. government uses to distribute surplus grain in the United States to grain-deficit countries abroad.

PUT OPTION. An option which gives the buyer (holder) the right, but not the obligation, to sell the underlying futures contract at the strike price on or before the expiration date.

PYRAMIDING. Adding to existing futures positions as the market moves favorably, by allowing profits on existing positions to be used as margin money for new positions--a very risky strategy.

-R-

RANGE. The difference between the highest and lowest price recorded during some time period. The time period may be a day, week, month, life of contract, or any given period.

RELATIVE STRENGTH INDEX. A technical tool, which uses price changes, rather than price levels, to indicate overbought or oversold market conditions.

RISK. The chance of an unfavorable outcome.

ROUNDTURN. A completed futures transaction initially begun by buying or selling a futures or options contract, which was later offset by an equal but opposite transaction. Brokerage commissions and fees for futures market transactions are usually based on a roundturn, whereas commissions and fees for options transactions are not.

-S-

SETTLEMENT PRICE. The price at which the clearing house of the futures exchange clears all the day's trades. This is used to determine gains or losses, margin requirements, and the next day's trading price limits. Settlement price and closing price are equal only if all trades at the close are made at the same price. More commonly, it is the midpoint in the range of closing prices.

SHORT. The position created by the sale of a futures or options contract if there is no offsetting position.

SHORT HEDGE. A selling or short hedge is taken in anticipation of a later sale in the cash market and is for protection against falling prices.

SPECULATOR. The market participant who uses the futures market for purposes other than hedging and who takes the opposite position in the futures market transaction from the hedger. Speculators are necessary to provide liquidity for hedgers using the futures market.

STORAGE HEDGE. A hedge used to protect against adverse price movements for grain in storage.

STRIKE PRICE. The price at which the buyer of an option contract may choose to exercise the option. The strike price is fixed for any given option.

-T-

TECHNICALS. A term which refers to a variety of chart-following techniques and chart patterns related to market price.

TECHNICAL ANALYSIS. Analysis which studies the market itself rather than the incorporation of factors of supply and demand. It uses a variety of tools to give buy-and-sell signals, or to predict a market top or bottom regarding a specific futures contract. Common technical tools include: bar charts, contrary opinion, Elliott Wave theory, moving averages, point and figure charts, relative strength indices, trend analysis, and volume and open interest methods.

TIME VALUE. Any amount by which an option premium exceeds the option's intrinsic value. If an option has no intrinsic value, its premium is entirely time value. Time value usually decreases as the option's expiration date approaches.

-U-

UNDERLYING FUTURES CONTRACT. The specific futures contract that may be bought or sold by the exercise of an option.

UNIT TRAIN. A train loaded by a single shipper, moving to a single buyer at a single location. Unit trains usually obtain preferential freight rates and schedules.

-V-

VARIABLE COSTS. Costs that change with the level of use. In storing grain, examples of variable costs include: insurance on the grain, shrinkage, interest foregone on the grain, and quality losses.

VOLUME. The total number of futures contracts traded in a given period of time. Frequently, the total volume reported will be for an individual commodity rather than an individual contract.

-W-

WHITE GRADING CERTIFICATE. A certificate which attests to grain grade and sampling technique, and which indicates that both sampling and grading were performed by an official inspection agency.

WRITER. The seller of an options contract.

-Y-

YELLOW GRADING CERTIFICATE. A certificate which attests to grain grade and sampling technique, issued to grain grade and sampling technique, issued by an elevator. Sampling was performed by the elevator with a mechanical diverter-type sampler, and grading was performed by an official inspection agency.

REFERENCES

Chicago Board of Trade. *Producer's Handbook: Commodity Marketing.*

McKissick, John C., et al. Agricultural Commodity Options: A Teacher's Guide. Extension Agricultural Economics, University of Georgia.

Russell, James R. and James C. Hanson. *Producer's Guide to Grain Marketing Terminology.* Fact Sheet #498, University of Maryland.