DEPARTMENT OF AGRICULTURAL ECONOMICS

Definitions of Marketing Terms

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Cash Marketing

Basis is the difference between a cash price and a futures price of a particular commodity on a given futures exchange. It is calculated as: Basis = cash price - futures price. Basis can be positive or negative.

Basis Contract is an agreement between a producer and grain elevator (or feedlot) that specifies the cash price upon future delivery as a fixed amount in relation to the futures price (above or below), thus fixing the basis.

Deferred Payment is delayed payment on the sale of a commodity, at a preestablished price.

Deferred Price Contract is a contract that transfers title of the commodity from the producer to the buyer, with the price to be determined at a future date.

Forward Contract is a contract for the cash sale of grain at a specified price for future delivery.

Minimum Price Contract is a contract that establishes a minimum (floor) sale price while allowing the seller to capture a higher price if prices rise.

Futures Market

Carry Spread is when the nearby futures month is trading at a lower price than a distant futures contract.

Carrying Charge is a futures market condition in which distant futures contracts are trading at successively higher levels than nearby contracts and above cash price offers. Carrying charges often indicate a surplus situation. A "full carrying charge" refers to carrying charge levels high enough to fully cover storage and other associated ownership costs.

Certified Stocks are quantities of grain designated and certificated for delivery by the exchange under its grading and testing regulations, to delivery points and/or warehouses specified and approved for delivery by the exchange.

Clearing House is the agency of the futures exchange responsible for matching purchases and sales, ensuring proper delivery procedures, and maintaining adequate financing by member firms.

Contract Grades is a quality definition established by the exchange to represent the standard type of grain acceptable for delivery against a futures contract. Included in the specification is the premium or discount for delivery of a nonstandard quality or type of grain.

Delivery is the settlement of a futures contract by receipt of the actual physical commodity or by the tender of a warehouse receipt covering a contract unit of the commodity.

Delivery Month is the specified month in which delivery is made under the terms of the futures contract.

Delivery Points are those locations (cities and/or elevators) designated by the exchange as authorized for placement of the physical commodity in fulfillment of an expiring futures contract.

Delivery Price is the settlement price designated by the Clearing House as the final price received or paid in fulfillment of a commodity futures contract.

Futures Contract is a contract traded on a futures exchange for the delivery of a specified commodity at a future point in time. Most futures contracts do not result in physical delivery. An offsetting transaction usually occurs prior to delivery and any price differences are settled in cash.

Futures Exchange (Market) is a centralized, regulated market where an actual commodity is not physically traded; instead, futures contracts are bought and sold.

Hedge involves taking a position in the futures market that is equal and opposite to the position one expects to take in the cash market, thus providing protection against adverse price movements.

Initial Margin is the margin deposit required by the exchange when a new futures trade is entered. See Margin Deposit.

Life of Contract is the period of time during which a particular futures contract is traded, from the first trading day to the last trading day. (Usually about 11 months for grains)

Limit Move is the maximum change in price from the previous day's settlement, as established by the exchange. The amount of a limit move may change from time to time as market conditions dictate.

Liquidation is the cancellation of a future sale (purchase) obligation by the off-setting purchase (sale) of the same futures contract.

Long refers to owning a futures contract or a cash commodity.

Long Hedge is the purchase of a futures contract to reduce the risk of a price increase. A long hedge is used to protect against rising input prices, such as corn for a livestock feeding operation.

Offset is the liquidation of a futures contract position. For the purchaser of a futures contract (long position), offsetting requires selling an equal number of contracts for the same delivery month. For the seller of a futures contract (short position), offsetting requires purchasing an equal number of contracts for the same delivery month.

Open Interest is the total number of futures contracts for a commodity that have not yet been offset or fulfilled by delivery of the commodity.

Position is an open commitment in a market, long or short.

Rolling the Hedge Forward is liquidation of the original futures contract and the simultaneous purchase (long hedge) or sale (short hedge) of a more distant futures contract to maintain the hedge without holding it into the delivery month.

Settlement Price is the daily price at which the **Clearing House** settles a trade. Settlement prices are used to determine account values, margin calls, and invoice prices for deliveries. It is also called the clearing price.

Short refers to selling a futures contract or purchasing a cash commodity.

Short Hedge is the sale of a futures contract to protect against the risk of a decrease in the price of the physical commodity to be sold in the cash market at a later date.

Spread is the difference of price between two futures contract months. It also refers to the simultaneous purchase and sale of the same or related commodities with expectation that the price differential will result in a profit.

Bear Spread is the simultaneous sale of a nearby futures contract and purchase of a deferred contract, with the expectation that the nearby contract will lose relative to the deferred.

Bull Spread is a simultaneous purchase of a nearby futures contract and sale of a deferred contract, with the expectation that the nearby contract will gain relative to the deferred.

Storage Hedge is a short hedge placed following harvest with grain being stored on the farm or in a commercial elevator. Storing the grain allows the producer to take advantage of strengthening basis, should it occur, while the short hedge locks in a general price level and reduces price risk.

Technical Correction is a price change against the trend. It is caused by such considerations as chart formations, volume, open interest, or delivery conditions, rather than by fundamental (supply/demand) reasons.

Volume is the total number of contracts traded during a given day.

Making a Trade

At the Market is a term that instructs the broker to execute an order immediately at the current price at which the commodity is trading when the order enters the pit. It is also referred to as a Market Order.

Limited Order is an order to which there is some restriction attached as to the time or price for execution of the order.

Stop-Loss Order is an attempt to limit market risk by placing a liquidation order to be executed if the price moves to a designated level.

Margin Money

Margin Call is a notice that additional margin money is required to keep equity in your futures or options (if selling options) position. Margin calls may result from a loss in the futures or options position (if selling options) or from increased exchange requirements resulting from a higher price level or unusual market volatility.

Margin Deposit is a "good faith" deposit made by you with the brokerage house and deposited with the futures exchange. The money is held on account to insure against losses on open futures contracts and options (if selling options). A margin deposit is not a down payment, but rather a performance bond. The minimum margin is determined by the exchange and is usually lower for hedgers than for speculators.

Maintenance Margin is the margin deposit required by the exchange to keep equity in your futures or options (if selling options) position. It is required when the initial margin has been depleted by adverse price movement.

Margin to the Market is the opposite of a margin call. When a profit accrues to your futures or options (when selling options) account, you may withdraw money from the account, reducing the balance to the minimum maintenance margin deposit requirement.

Options

At-the-Money refers to an option with a strike price that is equal to, or nearly equal to, the price of the underlying futures contract.

Call Option is 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 option’s expiration date.

Exercising Options is initiated by the buyer of an option. The buyer takes ownership of the underlying futures contract at the specified option strike price. The seller is obligated to take the offsetting transaction.

Expiration Date is the day when the holder of the option loses the right to exercise the option.

In-the-Money, for a put option, is when the strike price is above the current price of the underlying futures contract (the option has intrinsic value). A call option is in-the-money when the strike price is below the current price of the underlying futures contract (the option has intrinsic value).

Offset is the liquidation of an options contract position. For the purchaser of an option (put or call), offsetting requires selling an equal number of contracts for the same delivery month at the same strike price as originally purchased. For the seller of an option (put or call), offsetting requires purchasing an equal number of contracts for the same delivery month at the same strike price as originally sold. (The majority of options are offset as opposed to exercised).

Option Buyer or **Holder** is a person who buys an option.

Option Premium is the price of an option, which is paid by the buyer and received by the seller. Option premiums are determined by open outcry of competitive bids and offers in a trading pit.

Option Writer or **Grantor** is a person selling an option.

Out-of-the-Money refers to an option that has no intrinsic value. For a put option, this occurs when the strike price is below the current futures price. For a call option, this occurs when the strike price is above the current futures price.

Put Option is an option that gives the 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.

Strike Price is the price at which the holder of an option may choose to exercise his right to buy (call option) or sell (put option) the underlying futures contract.

Miscellaneous

Bear is a person who expects lower prices

Bear Market is a market in which prices are declining.

Beef Alliance is a marketing effort to secure higher market prices. An alliance usually consists of a group of producers, often using vertical Improving product quality and consistency are often goals of beef alliances.

Bull is a person who expects higher prices.

Bull Market is a market where prices are increasing.

Commission is the brokerage fee for entering and liquidating a futures or options contract.

Crop Year represents the 12-month period between the beginning of harvest one year and the beginning of harvest the following year.

Equity is the difference between the original purchase or sales price and the current market price of a commodity futures contract or option premium.

Fundamental (Analysis) refers to the analysis of market supply and demand conditions for a commodity.

Marketing Plan is a written plan for each commodity produced. It specifies production costs, price goals, potential price outlook, production and price risk, and a strategy for marketing the commodity.

New Crop represents the crop to be harvested for the coming crop year. Depending on the commodity and contract month, futures contracts reflect either new crop or old crop production.

Old Crop represents the most recent crop harvested. Depending on the commodity and contract month, futures contracts reflect either new crop or old crop production.

Price Slide establishes the price adjustment for differences between projected livestock base weight (after shrink) and actual sale weight (pay weight). Price slides are necessary because heavier weight cattle usually sell for a lower price per hundred weight than lighter weight cattle.

Retained Ownership involves vertically integrating the cow-calf operation by retaining calves beyond weaning, thus carrying them into the next phase of preparation for the market place. Backgrounding, grazing, and feeding through a feedlot are all retained ownership strategies.

Speculation is the attempt to anticipate commodity price changes and to profit through the purchase or sale of either the commodity futures contract or the physical commodity.

Speculator is a nonhedging trader, one who assumes risk positions with the hope of making a profit rather than hedging future cash purchases or sales.

Technical Analysis refers to an analysis of the market based on technical aspects such as price chart formation, volume and open interest.

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File code: Marketing 1 November 1998