

At the money

An option contract whose strike price is the same as the current price for the underlying futures contract is said to be 'at the money'.

Average Basis Pool

The grower nominates a set number of bales in 100 bale lots (100 bales = 1 contract) and accepts the average basis of all bales sold within this pool. The advantage of this basis is that 'force majeure' usually operates. The disadvantage is that the grower does not know the value of the basis until the merchant has set the basis on all the bales in this pool.

Basis

Difference between the price in a particular cash market and the nearby futures price.

Basis forward contract

Forward contract in which the sale price is set at a fixed margin with respect to a particular futures price.

Call Option

Option to buy futures contract at a specified price - the strike price - prior to a specified date. The futures contract concerned would confer (in principle) future receipt of the commodity.

Call pool

Delivery alternative for Australian cotton growers whereby they commit a quantity of cotton to a particular marketing organisation, while retaining the freedom to hedge using futures and options. Each grower can choose when to 'lock in' (in effect, ensure receipt of) the then quoted May or July US futures price, and likewise when to 'lock in' the Australian basis and the rate of exchange of US dollars into Australian dollars.

Cash market (spot market)

Market in which immediate exchange of the physical commodity takes place. Payment for the commodity is received on or soon after the day of exchange.

Clearing house

Institution through which all futures contracts are made, and are either 'closed out' or are fulfilled by physical delivery of the commodity after matching purchases with sales. It operates a system of margin payments to ensure the integrity of futures and option contracts.

Cotlook A index

Average quotation for middling 1½ inch cotton, including freight to northern European ports. Cash price for cotton from twelve different countries or areas are used to form this index, which is defined as the average of the lowest 5 of the 12 prices.

Extrinsic ('time') value (of an option contract)

A component of an option premium that reflects the probability that the price of the underlying futures contract will change to a level at which it is profitable for the holder to exercise the option.

Fixed price forward contract

Forward contract in which a certain price (as distinct from a formula for a variable price) is established at the time the contract is signed.

Fixed Basis Pool

The grower nominates a set number of bales in 100 bale lots. When the grower is confident of producing the quantity committed to this pool, they will agree on a fixed basis with their merchant. The advantage of this is that the grower knows the exact price of the basis to calculate their return per bale. The disadvantage, particularly for dryland growers, is that 'force majeure' does not apply and therefore the grower has an obligation to deliver the physical bales.

Force majeure

'Act of God' such as drought, which is accepted as excusing fulfilment of a contract.

Forward contract

A binding contract specifying the price (or price formula such as basis), quantity and quality of a product to be delivered at some specified date. The quantity may be expressed in units of output or as the production from a specified area.

Forward exchange rate

Rate of exchange between two countries' currencies which is contracted to be applied at some time in the future.

Forward points

Difference between the currently quoted forward exchange rate and the current spot exchange rate, in hundredths of a cent.

Futures contract

A legally binding document requiring, at a standard date, either delivery or acceptance of a given quantity (50,000lbs, in the case of cotton) and quality of a commodity. It is, in effect, a forward contract in which the main elements have been standardised for all traders. Only the price for a transfer of the 'contract' itself is negotiated. The current price of a futures contract determines the current futures price of the commodity. A contract to deliver can be 'closed out' by buying a futures contract to take delivery; and vice versa.

Futures price

The price agreed by open competition, at any given time, for a commodity which will be delivered on a specified month. There is a fixed set of months for this purpose (March, May, July and December in the case of cotton), and a fixed set of delivery points. For cotton, futures prices are established at the New York Cotton Exchange.

Hedging

Process of reducing risk by arranging transactions with counterbalancing risks in a number of different markets.

In the money

An option contract is said to be 'in the money' when its strike price is at a level in relation to the current price for the underlying futures contract such that it would be profitable to exercise the option.

Intrinsic value

Value, if any, that an option would have if exercised at the present time; the difference between the current price of the underlying future contract and the option strike price.

Long

The purchaser of a futures or option contract is said to take a long position. In the case of a futures contract, 'long' denotes, in principle, ownership of a commodity. In the case of an option, it simply denotes possession of the option, regardless of whether the option is to buy or to sell.

Margin call

Payment that the holder of a futures (margin payment) contract (either for acceptance or delivery) must make to the clearing house if the future price moves in a direction adverse to the holder.

Nearby future prices

At any point in time the future price for the next in the series of fixed delivery dates.

Option contract (option on futures)

Conditional contract to buy or sell (see call, put) a futures contract at a specified strike price. The option is exercised only if and when the option holder so decides. It is available only up to a specified date.

Option Premium

Payment by the buyer of an option contract to the seller of that contract. The premium can be considered as consisting of the two components: the intrinsic value and the extrinsic (or time) value.

Out of the money

An option contract is said to be 'out of the money' when its strike price is at a level in relation to the current price for the underlying futures contract such that it would not be profitable to exercise the option.

Put option

Option to sell a futures contract at a specified price - the strike price - prior to a specified date. The future contract concern requires (in principle) future delivery of the commodity.

Seasonal pool

Delivery alternative for Australian cotton growers whereby they commit either a specified quantity of cotton or the production from a specified area to a particular marketing organisation. Each grower who delivers to this pool subsequently receives the average price the organisation obtains for all the cotton delivered to the pool during the same season (with adjustments to reflect quality differences)

Short

The seller of a futures or option contract is said to take a short position. In the case of a futures contract 'short' denotes an obligation, in principle, to supply a commodity. In the case of an option, it simply denotes being subject to the purchaser's right to exercise the option, regardless of whether the option is to buy or sell.

Spot exchange rate

The current rate for immediate exchange between two countries' currencies.

Spot market

See cash market.

Strike price

The specified price at which the holder of an option contract can sell the underlying futures contract - in the case of a call option.