Introduction to Futures Trading

A basic understanding to
start trading the futures markets.

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Important Information About Trading Futures and Options on Futures

This communication is intended as solicitation. There is a substantial risk of loss in trading commodity futures, options and foreign exchange products and is not suitable for all investors. The data and comments provided herein are for informational purposes only and must not be construed as an indication or guarantee of any kind of what the future performance of the concerned markets will be. Contact your account representative for more information on these risks. Information and opinions contained herein come from sources believed to be reliable by R.J. O'Brien & Associates Canada Inc. (RJO Canada) but are not guaranteed as to accuracy or completeness. All trading decisions will be made by the account holder. Please carefully consider your financial condition prior to making any trading decisions.

When analyzing option strategies, it is important to take into account the commission and fees associated with making a trade. Similar to trading futures, each contract executed in an option strategy is charged commission and fees. Commissions and fees from brokerage firms can be up to $99 per round turn with the vast majority of people paying significantly less. Your actual charges may vary based on the service level you choose. The two primary factors investors tend to overlook when trading options include:

- Each contract traded is charged a commission. This is often misinterpreted as each spread or strategy that is charged a commission. If you trade one bull call spread, your account would be charged for 2 contracts rather than 1 spread.
- Customers often try to sell or collect premium on options that are far out of the money with the belief that they are collecting "easy money." The further away an option strike price is from the current market price, the lower the value of the option. Make sure that you are not paying more in commission and fees than what you are collecting. Keep in mind that until an option expires, you do hold risk in the positions. Is the net premium collected after paying commission and fees worth the risk?

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Getting Started

Many of the savviest traders in the world trade futures. For starters, they appreciate the exposure to worldwide markets on regulated exchanges and regulated counterparties.

They also like increasing the efficiency of their trading capital via the leverage available in futures (which can also work against you). And, finally, they know they can count on the futures markets' liquidity to help them execute their ever-changing strategies.

You can be a savvy futures trader, too. This guide will start you down the path with a good explanation of the basics—from how prices are quoted to understanding margin to trading strategies. We hope it will inspire you to try your hand trading some of the most exciting markets in the world.

RJO Canada, a leading brokerage firm for derivative products, is specialized in serving futures and options traders. Everyone on our team is devoted to providing the service you need to become a successful futures trader.

A list of guides from RJO Canada covering more specific futures trading topics—as well as additional resources for learning the basics—is at the end of this document.

Please feel free to contact us to answer any questions you have about trading futures. Any of our experienced team can explain the principles and strategies in this guide, and help you understand if trading futures is right for you. If so, we look forward to welcoming you as a new client at RJO Canada.

Futures 101

Futures contracts are financial instruments focused on discovering the price of a specific commodity or asset at a specific time in the future—anywhere from tomorrow to years from now.

Most often, though, futures traders are focused on price prospects over the next few months.

In futures, as information about the supply and demand for the underlying asset changes over time, the price of the futures contract changes as traders take positions based on their opinion of what the asset's price will be at that certain point of time in the future.

What is a Futures Contract?

A futures contract is an obligation to buy or sell a specific quantity of a certain commodity or asset on a future date at an agreed upon price.

Because the terms of futures contracts for each commodity or asset are standardized (i.e., same quantity, quality, delivery), they can be traded on an exchange. The only variable is the price.

Today, futures contracts represent commodities and financial instruments you know and hear about in the news every day, including oil, corn, gold, popular stock indices and foreign currencies.

How Futures Trading Works

Futures trading occurs on regulated exchanges, which facilitate the place where buyers and sellers trade as well as post-trade clearing. In the United States, futures trading began in the mid-1800s as a way to bring together producers and users of grains and cotton. Today, the CME Group in Chicago is the largest futures exchange in the world; its stock is listed on the New York Stock Exchange.

In futures trading, the buyer and seller create a new contract with each trade, and the number of contracts that can be created is limitless. In contrast, a limited number of shares of stock are available to trade for each company that is publicly listed and traded.

Remember, it's a "futures" contract. You are taking a position on what you think the price of something will be on the date the contract expires. If you're trading crude oil and you believe the future price of oil will be higher, then you would buy the contract. If you believe the future price will be lower, then you sell the contract.

What is Margin?

Margin is essentially a good-faith deposit. It represents a small percentage of the total dollar value of the contract you have agreed to buy or sell at a future date.

There are two types of margin. Initial margin is the amount of cash (or equivalent) you must have in your account at the time an order is placed. Maintenance margin is the dollar amount that must be maintained in the account to continue to hold the futures position.

Margin Call

A margin call occurs when there is not enough cash in the account to cover all the maintenance margin required to hold all the positions in the account. It is a call for money. A margin call generally occurs when prices move against your positions. Many experienced traders view a margin call as a red flag that their trading strategy might be flawed. Market conditions permitting, brokerage firms might allow up to four days to meet a margin call, even though they are due payable before the next trading day begins.

Expiration and Delivery

An important aspect of trading futures is understanding that futures contracts ultimately expire and cease to exist. On the expiration date, futures contracts may call for physical delivery of the commodity, while others are settled in cash. But, don't worry. When you make a futures trade, you don't need to make or take delivery of the commodity. In fact, if you're like the vast majority of futures traders, you will offset your position long before ever being faced with the delivery process.

To close out a position in a futures contract, and avoid delivery, you offset the contract by taking an equal, but opposite, position in the same contract month. Thus, if you were long a futures contract (i.e., having bought a contract), you would sell a matching contract; if your initial position were a sale, you would buy to offset it. Either of these actions exits your position and gets you even.

Counterparty

Once you have a position in a futures contract, that contract is cleared and held at a clearinghouse, which ultimately is your true counterparty so that you may exit the position at any time. The futures exchange clearing corporations handle this process automatically.

Trading Symbols

In futures trading, each commodity has its own symbol, e.g. “C” for corn or “ES” for the E-mini S&P 500. However, each market might have more than one symbol to represent contracts trading on different exchanges or on different platforms, e.g. trading pit or electronic. For example, wheat in the Chicago Board of Trade trading pit is “W,” but is “ZW” on the CBOT’s electronic platform and “KW” for Kansas City Wheat.

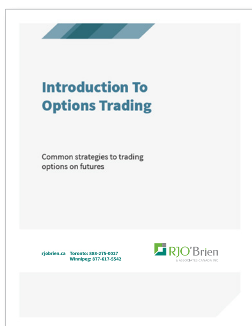
Your RJO Canada representative can help you find the contract symbol for the product, exchange and platform you wish to trade.

Each commodity contract has an expiration month that also is abbreviated by symbol:

Contract Month Symbols	
January	F
February	G
March	H
April	J
May	K
June	M
July	N
August	Q
September	U
October	V
November	X
December	Z

As an example, the symbol for the July 2016 soybean contract at the Chicago Board of Trade would be SN6 for the pit-traded contract and ZSN6 for electronic trading.

ADDITIONAL RESOURCES



For more information on options trading, **call 888-275-0027** to request your free copy of the Introduction to Options Trading guide.

Know Your Contracts

Commodity	Symbol		Unit of Trade	How Quoted	Value
Grain Futures	**PIT**	**E-CBOT**			
CBOT Corn	C	ZC	5,000 bushels per contract	Cents per bushel	1 cent = $50
CBOT Wheat	W	ZW	5,000 bushels per contract	Cents per bushel	1 cent = $50
CBOT Soybeans	S	ZS	5,000 bushels per contract	Cents per bushel	1 cent = $50
CBOT Soybean Oil	BO	ZL	60,000 pounds per contract	Cents per pound	1/100 cent = $6
CBOT Soybean Meal	SM	ZM	100 metric tons per contract	Dollars per ton	$0.10/ton= $10
CBOT Oats	O	ZO	5,000 bushels per contract	Cents per bushel	1 cent = $50
Meat Futures	**PIT**	**GLOBEX**			
CME Live Cattle	LC	GLE	40,000 pounds per contract	Cents per pound	.025 cents = $10.00
CME Feeder Cattle	FC	GF	50,000 pounds per contract	Cents per pound	.025 cents = $12.50
CME Lean Hogs	LH	HE	40,000 pounds per contract	Cents per pound	.025 cents = $10.00
Metals Futures	**PIT**	**GLOBEX**			
NYMEX Gold	GC	GGC	100 troy ounces per contract	Dollars per troy ounce	1 dollar = $100
NYMEX Platinum	PL	GPL	50 troy ounces per contract	Dollars per troy ounce	$0.10 per oz.= $5
NYMEX Silver	SI	GSI	5,000 troy ounces per contract	Dollars per troy ounce	1 cent = $50
NYMEX Copper	HG	GHG	25,000 pounds per contract	Cents per pound	1 cent per lb = $250
Petroleum Futures	**PIT**	**GLOBEX**			
NYMEX Crude Oil	CL	GCL	1,000 barrels per contract	Dollars per barrel	$0.01 per barrel = $10
NYMEX Heating Oil	HO	GHO	42,000 gallons per contract	Dollars per gallon	1 cent per gal = $420
NYMEX RBOB Gasoline	RB	GRB	42,000 gallons per contract	Dollars per gallon	1 cent per gal = $420
Softs	**PIT**	**ICE**			
NYBOT Coffee	KC	IKC	37,500 pounds per contract	Cents per pound	1 cent = $375
NYBOT Sugar #11	SB	ISB	112,000 pounds per contract	Cents per pound	1 cent = $1120
NYBOT Cocoa	CC	ICC	10 metric tons per contract	Dollars per metric ton	$1 per ton = $10
NYBOT Orange Juice	OJ	IOJ	15,000 pounds per contract	Cents per pound	1 cent = $150
NYBOT Cotton	CT	ICT	50,000 pounds per contract	Cents per pound	1 cent = $500
Currencies	**PIT**	**GLOBEX**			
CME Euro FX	EC	GE	$100,000 per EC per contract	Dollars per foreign currency	0.0001 = $12.50
CME Canadian Dollar	CD	GC	$100,000 per CD per contract	Dollars per foreign currency	0.0001 = $10
CME British Pound	BP	GB	$62,500 per BP per contract	Dollars per foreign currency	0.0001 = $6.25
CME Japanese Yen	JY	GJ	$1,250,000 per JY per contract	Dollars per foreign currency	0.0000001 = $12.50
Stock Index Futures	**PIT**	**GLOBEX**			
CME S&P 500	SP	GS	$250 times the index	Dollars per index	0.10 = $25
CME S&P Emini		ES	$50 times the index	Dollars per index	0.50 = $25
Mini Dow		YM	$5 times the index	Dollars per index	1 = $5

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Price Quotes

Futures contracts are not all priced in dollars and cents, with a handy decimal point and two numerals behind it. So, it is important to understand how the market you are trading is quoted. For example, the grains have minimum ticks of quarter-cents while T-bonds are priced in 32nds, sugar in points based on the contract size and some stock indices in multiple-point increments.

Your RJO Canada representative can explain how the markets are priced and how to decipher a quote on the quote system you are using. For example, a corn quote might read $4.2525 for $4.25 and ¼ cents per bu., or it could be listed old-school as 4252, where the last digit represents 2/8 of a cent, or ¼ cent.

Note that the opening price is generally the midpoint of the opening range or a single price designated by the exchanges. The end-of-day value of a futures contract used to determine margin calls is called the “settlement” price. Settlement prices are determined by exchanges based on closing prices.

Volume

Volume tells you how many contracts traded hands in a particular contract or market. Total volume equals all contracts traded. (The purchase and sale of a single contract counts as one, not two.) Volume helps measure the strength of price movements.

Open Interest

Open interest tells you how many contracts exist—are live or active—in the market at any given point in time. This is similar to the number of shares outstanding for a stock. The larger the open interest, the greater the liquidity (i.e., ease with which you can enter or exit the market).

Who Trades Futures

Participants in the futures market fall into two broad categories—speculators or hedgers. Speculators take risk and provide liquidity for hedgers who are seeking to dispose of any number of kinds of business risks they face.

Speculators

Speculators take risk and seek to profit from the ups and downs of futures prices. Speculators can be individuals like you to professional traders working alone or within trading groups. They also could be institutional money managers. But, whoever they are, profit is their primary objective.

Similar to stock trading, speculators in futures use both fundamental and technical analysis to generate signals as to the future price movements of a specific contract. They might trade support and resistance levels from a futures price chart. Or, they might study global supply and demand. Professional traders increasingly use computerized algorithms to monitor the markets and take advantage of very slim pricing opportunities. The volume of trading generated by speculators provides liquidity for hedgers.

Hedgers

Hedgers use the futures markets to get rid of the price risk that is inherent in their business. Farmers, food processors, energy producers—and even corporate treasury departments—are examples of hedgers who lock in prices using futures contracts to protect against price movement and volatility. Hedging becomes a form of price insurance as it establishes a price for something they intend to buy or sell in the cash market at a future date.

Stock traders can hedge, too. Let's say you hold a broad range of stocks or a stock index in your portfolio. You are concerned about near-term performance given market conditions, but do not want to lighten your holdings because of capital gains tax consequences — plus, long-term you're bullish. Selling a stock index futures contract could protect your exposure to a drop in the stock market.

Why Trade Futures

Let's get right to it. Why should you even be interested in futures trading? What's in it for you?

Leverage

This is the big one for most traders. In futures trading, the capital you devote to holding a position is substantially less than what you need to hold an equities position—even on margin.

A non-margined equities account requires you put up 100% of the value of the security. Even a margin account may require an initial deposit of at least 50% of the stock's current value. In contrast, you typically are required to put up just 5%-20% of a contract's value to hold a futures position.

Your gain or loss, however, is still calculated as if you had deposited 100% of the value of the contract.

Leverage is what gives futures trading its reputation for being risky. Although it can make your money work harder and deliver more profits when you are on the right side of the market, leverage is equally effective at magnifying your losses if the market is going against your position.

There is no doubt that leverage is a two-edged sword. Experienced futures traders will tell you that using stops, taking small losses and being vigilant about your risk-management practices will help you stay on the right side of the leverage beast.

Ask your RJO Canada representative about current minimum margin requirements for the markets you are interested in trading. Be aware that margin requirements can change at any time, and are particularly likely to do so when the markets are volatile. Also, you can always commit more capital to margin than the minimum requirements in order to reach a comfortable level of leverage for you.

Example of Leverage:

At $6 per bu., a 5,000-bu. corn futures contract is worth $30,000. If the price of corn rises by 10% to $6.60, the contract is then worth $33,000—a gain of $3,000 for someone who is long futures at $6.

If the margin requirement for one corn futures contract is $2,000, then a 10% price increase (and gain of $3,000 in contract value) means a futures trader made a 150% return on the capital required to hold the position, however a 10% price decrease results in a corresponding loss.

Tax Advantages

Consult your accountant or the Canada Revenue Agency for tax information.

Increased Opportunity

Futures trading appeals to those who embrace opportunity and freedom. For example, futures trading does not discriminate against someone who wants to trade on the short side of the market. The margin and order-entry requirements to sell short are the same as if you want to be long. You don't have to "borrow" anything to get into a short position, and there's no uptick rule for selling short.

Second, many futures markets—even U.S. stock indices—are open virtually 24 hours day from Sunday night through Friday afternoon. You're able to trade when it's convenient for you—or whenever global news prompts you to take action.

Asset Diversification

Futures allow investors to broaden the range of asset classes held in their portfolios, thereby potentially reducing risk and improving long-term returns. According to a study published by the CME Group, portfolios with as much as 20% of assets in managed futures yielded up to 50% more than a portfolio of stocks and bonds alone.

Futures also allow a "pure play" with the underlying commodity that simply is unavailable with stocks, even those with strong correlation. For example, a mining stock could be considered as having exposure to the gold market. But it is not a "pure play" because other factors exist, e.g., sector influence and corporate management, that affect the value of the security but are not related to the commodity's price.

Financial Protection

Futures trading has its roots in protecting against the risk of adverse price movement. Indeed, the markets began in the mid-1800s as a way for commodity producers and users to "hedge" against prices going against their best interest. Today, companies worldwide do exactly that, particularly with financial futures contracts that cover stocks, interest rates and currencies.

Basic Futures Trading Strategies

The most-often used trading strategies in the futures markets are pretty simple. You buy if you think prices are going up or sell if you think prices are going down.

And, in futures trading, selling first is just as easy as buying first—the positions are treated equally from a regulatory point of view.

The following two strategies are just a starting point. For more advanced futures-trading strategies, request the RJO Canada guide "Introduction to Spread Trading." Or, learn some trading strategies for options on futures with the RJO Canada guide "Introduction to Options on Futures Trading."

Buy Futures

If you expect a futures market's price to be higher in the future than it is today, you would buy a futures contract, or "go long." If you are right about both market direction and timing and the price indeed rises, you can then sell the same futures contract to collect your profit (minus commissions and other fees).

However, if you are wrong about the market's direction or your timing is off and prices ultimately fall, then you will take a loss when you exit the position. And, because of the leverage in futures, that loss could be greater than your initial margin deposit.

Here's an example, using July 2106 soybeans trading at $13.00 per bushel in January 2016. In January, you think soybean prices are likely to rally into the summer, so you put up $4,000 in initial margin and buy a July 2016 soybean futures contract.

Four months later, soybean prices have rallied $1 per bushel and you decide to take your profits and close out your long position by selling a July 2016 soybean futures contract. That generates a profit of $5,000 (minus commissions and fees*), or return on initial margin of 125%.

		Price per bushel	Value of 5,000-bu. contract
January	Buy 1 July soybean futures contract	$13.00	$65,000
April	Sell 1 July soybean futures contract	$14.00	$70,000
Gain		$1	$5,000

*Commissions and fees from brokerage firm can be up to $99 per round turn with the vast majority of people paying significantly less. Your actual charges may vary based on the service level you choose. See disclaimer on inside cover for detailed discussion.

Of course, there's always the possibility that prices don't behave as you expect. If soybean prices dropped $1 per bushel from January to April and you exited your initial long position at a loss, you would have lost your initial margin of $4,000 plus an additional $1,000 (plus commissions and fees*).

		Price per bushel	Value of 5,000-bu. contract
January	Buy 1 July soybean futures contract	$13.00	$65,000
April	Sell 1 July soybean futures contract	$12.00	$60,000
Loss		$1	-$5,000

Sell Futures

The concept of selling something you don't own is often a stumbling block for traders new to futures. But it's easy to overcome. Just remember that a futures contract simply represents the commitment to either sell or buy an asset at a future date. So when you sell to initiate a position, all you're committing to is selling at that price in the future. In the meantime, you don't need to own the underlying commodity or financial instrument.

Selling a futures contract as your initial position is just as simple as buying a futures contract. You believe the price will go down, so you sell. If you ever traded stocks, you'll be glad to know that no borrowing or loan fees are involved with shorting futures. You simply sell as easily as you buy.

If you are correct in your market direction and timing and prices decline, then you can profit from your short position by simply buying the same contract. However, if the market moves against your position and rallies, then you would suffer a loss when exiting—and the loss could be more than what you put up to make the trade.

As an example, you believe in January that soybean prices will fall into the summer. So, you put up $4,000 in initial margin to take a short July soybean futures position. By April, the market has fallen $1 per bushel, which equates to a $5,000 decline in the value of the contract. Because you shorted the market when the contract value was higher, you can buy it back at the lower price and make $5,000 (minus commissions and fees*).

Note: Commodity accounts are marked-to-market on a daily basis and if the account value depreciates below maintenance margin requirements, a margin call will be generated so that the client must bring the account value up to initial margin requirements.

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		Price per bushel	Value of 5,000-bu. contract
January	Sell 1 July soybean futures contract	$13.00	$65,000
April	Buy 1 July soybean futures contract	$12.00	$60,000
Gain		$1	$5,000

However, if soybean prices rally $1 from January to April, your short position will show a $5,000 loss (plus commissions and fees*) if you buy July futures to exit the position.

		Price per bushel	Value of 5,000-bu. contract
January	Sell 1 July soybean futures contract	$13.00	$65,000
April	Buy 1 July soybean futures contract	$14.00	$70,000
Loss		$1	-$5,000

ADDITIONAL RESOURCES

Click for your RJO Futures PRO demo!
An exclusive and sophisticated online trading platform like no other with integrated tools to seamlessly trade and monitor the markets. Test drive a demo today with a Free 100K simulated account with real time data & execution.

Or, call 888-275-0027 to request your free demo.

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Get Comfortable with Futures

	Futures	Stocks
Represents	A commitment to buy or sell something in the future at an agreed-upon price	Ownership of a corporation
Trading	Traded on a regulated exchange	Traded on a regulated exchange or through a dealer association
Issued by	A futures exchange writes the terms of each contract and makes it available for trading	A corporation
Maximum number that can be outstanding	No limit to the number of futures contracts that can be traded	Set by the company's charter; issuance regulated by filings with regulators
Margin	Requires deposit of about 5%-20% of the value of the futures contract, depending upon price level and volatility	If purchased in a margin account, usually requires minimum initial deposit of 50% of the value of the security; the remaining 50% is considered a loan from the broker who charges interest
Selling short	As easy as buying	Requires borrowing stock, if available, and selling when price is rising
Timing	Fixed expiration date, usually less than 18 months	Stocks are perpetual instruments as long as the underlying company remains solvent
Fundamental analysis	For commodities, research analysts provide views of supply/demand and other economic factors or physical conditions (e.g., weather) that could affect values For financial futures, the same stock research applies	Research analysts provide views of micro and macro economic factors that could affect values
Technical analysis	Traders chart price movements to analyze patterns and support/resistance levels; this generates buy/sell signals	Traders chart price movements to analyze patterns and support/resistance levels; this generates buy/sell signals
Risk of loss	Because the purchase or sale of a futures contract requires only a small percentage deposit of the total value of the contract, a client can lose more money than the initial deposit	In terms of potential loss, a stock bought on margin works the same as a futures contract A non-margined stock purchase requires a 100% deposit and therefore represents the total potential loss

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Additional Resources

Thank you for the opportunity to provide you with this educational material. Anyone can offer online trading in online markets. But RJO Canada is not just anyone. We are specialists devoted to delivering the best possible trading experience for our clients. Whether you want to trade on your own or tap into the experience of our market strategists, you can do it all at RJO Canada, a leading provider of futures brokerage services.

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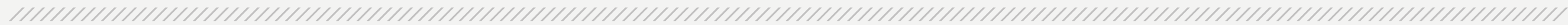
RJO Futures Brokers

The The RJO Canada Market Strategists provide the experience and background to help you with your trading needs, and assist you with reaching your trading goals.

Click to contact our team.



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