THE LANGUAGE OF COMMODITIES

A Commodity Glossary

Rosemary Erickson

George Steinbeck

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Roser[illegible]y Erickson

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Preface

The once small market place where agricultural products were traded is no more. The commodity industry has grown into many large, complex, and unique markets with

- seemingly endless product introductions,
- new and changing regulations, and
- new participants continually entering into this wonderful, exciting world of commodities.

Each contributes to the growth of something else: *the language of commodities*.

No doubt about it, even the most seasoned individual will be faced with new and arcane terms.

How does one keep up?

This work is meant to aid you in doing just that. The need is evident.

Key words and phrases were selected from the futures, options, forwards, and actuals markets. Commonly used terms of peripheral industries—such as shipping, import and export, insurance, banking, and credit—were included as they relate to our industry.

These terms were then carefully researched and discussed to determine the meanings as they relate to our industry. Although every effort has been made to assure valid, authoritative definitions, be aware that they may represent the authors' interpretation and should not be considered a "legal" definition. The authors are not lawyers but individuals who daily live in the world of commodities.

This glossary is intended for use by anyone who needs—or simply wants—a clear, easy-to-understand source of terms used in the industry. Therefore, it will benefit a wide variety of readers—direct participants, those in the peripheral businesses, potential investors, students, teachers, or the person who just likes to know.

Our Special Thanks
We would like to acknowledge the help of several respected individuals of the commodity industry who contributed their personal time and encouragement during the development of this project:

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Special mention goes to Charles E. Robinson, Senior Vice President of the Futures Industry Association, Inc. who this time—as always—found the time to contribute invaluable assistance. He is a true benefactor of the commodity futures industry.

How to
Use This Book Effectively

Terms

The words, abbreviations, and phrases in this glossary are printed in **bold face** and located at the left margin.

Definitions

One or more definitions in the column to the right of each term.

No judgment has been made as to the most frequently used definition as the reader would determine which is most commonly used in a particular area. For example, the most frequently used meaning for Actual Price in the futures area would be different from the most frequently used meaning of the same term for a reader in the cash market.

Alphabetization

All terms at the left-hand margin are arranged alphabetically, letter by letter rather than word by word or by main words.

Sometimes several terms in the industry have the same meaning. In such cases, the first term alphabetically carries the definition. All other terms carry a cross-reference to the first term.

Any synonymous term(s) further in alphabetic arrangement are cross-referenced directing the reader to the term carrying the definition.

Cross-References

Cross-references are represented by the word **See** and the term(s) in *italic print*.

This notation following a definition directs the reader to another entry:

- to get additional information on the given term,
- to distinguish shades of meaning between terminology or
- to express an antonym.

This notation following the word alone directs the reader to the synonym carrying the definition.

When more than one term is listed and separated by slashes, the first term carries the definition. When more than one term is listed but with no separating slashes, each term carries a definition.

Example

Examples have been included for further clarification, as necessary.

Appendixes

At the end of this book (page 192) you will find an appendix entitled "How to Read the Commodity Financial Quotes." This is a step-by-step description for reading and using the financial pages of the daily newspaper or screens from retrieval services.

Another appendix, entitled "Basic Calculations" (page 194), demonstrates the use of formulas and calculations done on a daily basis.

The appendix "How to Find a Commodity Factor (page 196) explains how to translate information given in the financial pages into the component used in commodity formulas—"factor."

The appendix called "Reference Guides" (page 197) displays frequently used commodity abbreviations for exchanges, organizations, and ticket symbols.

A

AA

The standard abbreviation for *Against Actuals*. The exchange of a futures position for the physical commodity made between a buyer and seller.

Also known as: *Exchange of Cash for Futures, Exchange of Spot (for Futures), Exchange for Physicals, EFP, Exchange Against Actuals, Cash Commodity for Futures*

> **Example:** A processor has inventory in storage for needs in the next few months. The processor is approached by another party for supplies and is offered an attractive price. To take advantage of the price and retain the protection of having sufficient supplies when needed, the processor requires a coffee futures contract in return for the physical coffee. The swap is registered with the exchange but is not entered via the trading ring.

Abandonment

The means of giving up the rights of an option by allowing the option contract to terminate on a specified calendar date (the expiration date).

Example:

Option	*Strike*	*Expiration Date*
Long 1 MCH 8X Gold Call	@ 360	2/10/8X

> If on 2/10 the price of the futures is below 360, the holder of the option will not exercise his/her right to that futures because to do so would mean to take a built-in loss. By taking no action, the option is allowed to expire as of that date.

For actuals, abandonment is the refusal of a consignee to accept delivery of a shipment that is damaged and considered worthless.

The rights and obligations to the futures or actuals cease to exist.

Also known as: *Expiration*

Acceptance

Agreement of intention to carry out a transaction.

The taking of delivery.

A time draft or bill of exchange on the face of which a drawee writes the word "accepted" along with the date and place of payment.

Accommodation Trade

A prearranged, wash transaction through which one party enters into an order to assist another party to complete an illegal trade.

Account

A customer who buys and/or sells in a commodity market.

Also known as: *Trading Account*

A record of buy and/or sell transactions.

Account Classification

The separation of accounts into categories for easy recognition, especially during internal processing.

> **Examples:**
> Hedger, speculator
> Exchange member

Account Executive

An agent of a commission house who is responsible for dealing directly with the clients for compensation, generally a percentage. Responsibilities could include obtaining required documents, explaining rules and regulations, entering client orders, and giving general information, prices, and market conditions.

Also known as: *AE (the standard abbreviation), Registered Representative (RR), Registered Commodity Representative (RCR), Associated or Approved Person (AP)*

Account Type

An identification commonly used in the operational area to distinguish regulated from nonregulated accounting within the same account number.

> **Example:** A customer trades domestic and foreign commodities. The transactions for the two cannot, by regulation, be placed in the same account. Therefore, two designation identifiers are created and added to a base account number separating the domestic accounting from that of the foreign, while still maintaining one base control number.

3875 (acct base) 01 (domestic identifier)
3875 (acct base) 02 (foreign identifier)

Accumulate

A method of adding to a position over a period of time at the same or differing prices during market fluctuations, rather than in one purchase, at one time, at one price.

Active Market

A market of heavy trading.

A market with a large open interest.

Active Trading Months

The months designated by a given exchange for which trading in a given commodity product may be initiated.

> **Example:** Chicago wheat is traded for delivery in the following contract months: March, May, July, September, and December. Trading for March Wheat in a given year can be initiated and/or actively traded

during any calendar month from October (18 months prior to March of the given year) through March of that year.

Months with activity or commitments.

Example: COMEX Gold is permitted to trade in all 12 calendar months. Because of economic or market considerations, the market may not have all 12 months active.

Active	*Permitted*
January	January
February	February
	March
April	April
	May

March and May do not have an open interest or trading activity. Therefore, although trading is permitted in these months, they are not yet active months.

See: *Contract Months/Delivery Months*

Actual Price

The price of the actual commodity.

The price at which a futures contract is executed.

Example: Bought at 371 (price).

In a price-setting transaction, the price of one leg of a spread. The price is set at one of the prices traded during the given transaction day.

Example:

Buy 5M May Wheat
Sell 5M July Wheat
10-point spread, May price to be fixed

May traded at 340, 345, 346, 355
July traded at 345, 346

The trader may select any price between 340 and 355 recorded for May as the May actual price and receive the July sale at 10 points over May. The July price must be within the *permitted* July trading range for that day.

See: *Price Setting*
Possible Price

Actual(s)

The physical or cash (including financial instruments) commodity that is available immediately or within a given period of time.

The basis of a futures contract.

Also known as: *Cash Commodity, Physical Commodity, Spot Commodity*

See: *Futures*

ADP

The standard abbreviation for *Alternative Delivery Procedure*. A term of the contract under which the buyer and seller, via their respective brokers on the exchange floor, agree to delivery terms (port, grade, premium, or discount) other than those specified in the contract. Notification must be made to the clearing house.

Example: A traded contract such as crude oil that calls for delivery at a number of facilities in the state of Louisiana may, upon mutual agreement between the buyer and the seller, be changed for delivery in Texas, Oklahoma or New York. All liabilities and responsibilities remain with the two parties.

AE

See: *Account Executive*

Affiliated Person

A party who has ownership or control over a given entity.

An individual associated with a futures commission merchant in a capacity such as partner, officer, director, etc., as defined by the Commodity Futures Trading Commission (CFTC), who thereby falls under the trading regulations and standards of the CFTC but is not required to register with the CFTC as such.

See: *Associated Person*

Afloat

A physical commodity which is in transit on a vessel or in a harbor about to sail but not at the destination.

Against Actuals

See: *AA*

Aging (of Margin Calls)

A method of computing the number of days an outstanding margin call moves from a receivable to a liability status in compliance with the Commodity Futures Trading Commission's regulations.

Example:

Day	*Action*	*Status*
Monday	Call issued	Receivable
Tuesday	Call mailed	Receivable
Wednesday	1st day count	Receivable
Thursday	2nd day count	Receivable
Friday	3rd day count	Receivable
Monday	(next business)	Liability

Note: Monday and Tuesday occur on the same business day because the results of Monday's activity are not seen until Tuesday morning.

The example reflects the handling of most common accounts serviced by brokers. Exceptions are explained in the Commodity Futures Trading Commission regulations.

Alternate Delivery Procedure

See: *ADP*

AP

The standard abbreviation for *Associated Person or Approved Person.* An individual who works for a futures commission merchant, commodity trading advisor, and commodity pool operators as an account executive, soliciting and accepting customer orders. An associated person must be registered with the Commodity Futures Trading Commission and is subject to all qualifications and regulations set forth in the Commodity Exchange Act.

(Approved) Delivery Facility

A depository, vessel, equipment, etc., that meets exchange specifications and is deemed appropriate for delivery of the given commodity.

(Approved) Delivery Mechanism

The specified process for delivery of a given commodity, including certificates, documents, and facilities as set by the authorized exchange.

Approved Person

See: *AP*

Arbitrage

A trading technique, utilized by either the speculator or the hedger, that involves the simultaneous purchase of actuals or futures in a given market against the sale of similar or identical actuals or futures in a different market with the expectation that the difference in price between the two transactions will result in a profit.

Example: A trader believes the price of cash wheat is out of line with the futures market. He/she believes the price levels will narrow (be closer to each other).

Cash market	Buy 5M Wheat	@ 3.75/bu
Futures	Sell 5M Dec Wheat	@ 3.85/bu

If the reasoning is correct, and on 12/01 the original position is offset by

Cash market	Sell 5M Wheat	@ 3.80/bu
Futures	Buy 5M Dec Wheat	@ 3.83/bu

this trade would yield .05/bu in the cash market and .02/bu in the futures market.

If the reasoning is incorrect and the basis for wheat remains the same through December, the net difference would be zero, with no gain or loss.

If the reasoning is incorrect and the basis for wheat widens rather than narrows against the trade, the net result would be a loss.

See: *Spread(ing)*

Arbitrageur

A trader who uses arbitrage strategy.

See: *Arbitrage*

Arbitration

A system in which a third party negotiates the settlement of a dispute between two other parties. Arbitration is a quasi-legal process but legally binding on the parties involved.

Arbitrator

The individual or panel empowered to settle a dispute in arbitration.

See: *Claimant*
Respondent

Arrival Notice

An import document sent by a carrier informing the party to be notified of arrival date, shipment details, and free-time expiration.

Ascending Triangle

A chart price pattern formed by high prices in the same proximity in advances and low prices moving rapidly higher so that the slope side of the triangle goes in an upward direction. See Illustration A-1.

See: *Descending Triangle*
Pennant/Symmetrical Triangle

Ask(ed)

An indication of willingness, made at a given moment on the floor of an exchange, to sell a specific quantity of a commodity at a specific price.

The price made in the offer.

Also known as: *Offer*

See: *Bid*

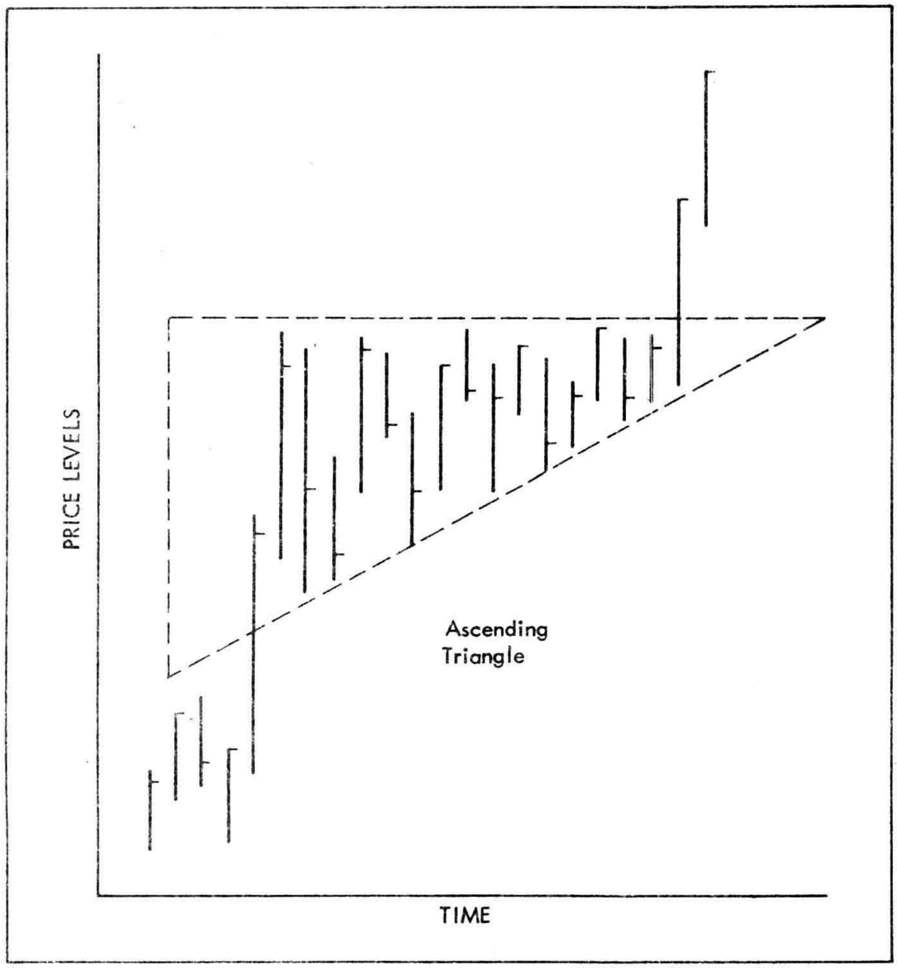

Illustration A-1

As-of Trade

A trade being recorded or booked on a calendar date after the actual execution date.

Example: Trade executed:

2/17 Bgt 1 Mar Copper 6100

Trade booked and confirmed on the next day:

2/18 Long 1 Mar Copper 6100 as of 2/17

Assignee

The recipient of the transferred legal rights specified in a (assignment) contract.

See: *Assignor*

Assignment

The conversion of a short option contract to the underlying futures contract at the specified, contracted strike price. A call is assigned into a short futures, a put into a long futures. An assignment is an obligation on the holder of a short position.

Example:

Option	*Strike*
Short 1 Feb COMEX Gold Call	@ 400.00
Short 1 Feb COMEX Gold Put	@ 380.00

upon assignment becomes .

Futures	Trade Price
Short 1 Feb COMEX Gold	@ 400.00
Long 1 Feb COMEX Gold	@ 380.00

This term is also used in transferring the rights of an option to the actual commodity.

See: *Exercise*

Assignor

The party that transfers ownership or legal rights in a (assignment) contract.

See: *Assignee*

Associated Person

See: *AP*

Assurance

A legal agreement whereby one party agrees to compensate another party for losses or damages.

The business of providing this protection.

Also known as: *Insurance The term assurance is more commonly used when referring to marine cases.*

The legal certificate or document which defines and guarantees this protection.

Also known as: *Insurance Policy*

Assured

The party of an insurance contract with the insurable interest or the one who would be injured by loss or damage. (The assured benefits from safe arrival of goods.)

Also known as: *Insured*

See: *Insurer/Underwriter*

At-or-Better

An order carrying a specific price. Execution will occur only at the specified price or a higher one (in the case of a sell, a lower one in the case of a buy).

Also known as: *Or Better Order (OB)*

Example:

Buy 5M May Wheat 330 or better

may also be written as

B 5M K WHT 330 OB

An execution of 330 or any price less than 330 is mandatory if this order is to be executed.

See: *Stop Loss Order*

At-the-Close

An instruction to buy or sell at the best price available during the closing period of the market on a given day.

Also known as: *Market on Close*

Example:

Sell 5M May Wheat Market on Close

may also be written as

S 5M K WHT MOC

The above order can be executed only during the exchange-specified closing period. If the market trades in the range of 350 to 360 during that time, any price in that range can be a trade price. It need not be the very last price traded, nor is it necessarily guaranteed to be the best price of the range.

See: *At-the-Open(ing)*

At-the-Market

An order to buy or sell a specified number of contracts for a specified commodity month at the best price available at the time the order reaches the trading ring.

Also known as: *Market order*

Example:

Buy 5M May Wheat Market

may also be written as

B 5M K WHT MKT

As long as the execution price represents the best offering at the time of execution and the price received was traded approximately at the time the order entered the trading ring, any price is acceptable.

See: *Contingency Order*

At-the-Money

The relationship of an option to the underlying futures contract. Whether call or put, long or short, the strike price of the option is equal to the current price of the underlying futures.

Example:
COMEX February Gold

Futures Settlement for January 4 @ 400.00

Option Strike Price	*Call Trade Price*	*Put Trade Price*
380	10.00	2.00
400	1.30	13.30
420	.20	32.20

All calls and puts trading at the 400.00 strike price on January 4 are considered at-the-money. Should the option be immediately exercised, no profit or loss would be realized.

See: *In-the-Money*
Out-of-the-Money

At-the-Open(ing)

An instruction to buy or sell at the best price available during the opening period of the market on a given day.

Example:

Sell 5M May Corn Market on the opening

may also be written as

S 5M K Crn Mkt opening only

Execution can take place only during the exchange-specified opening period. If the market trades in the range of 330 to 335 during that time, any price in that range can be the trade price. Trade price need not be the first price traded nor necessarily be guaranteed to be the best price in that range.

See: *At-the-Close*

At-Sight

A term signifying that payment is due immediately upon presentation of a given document or bill.

Auction (Market)

A system of trading on an exchange floor where buyers and sellers compete via open outcry with other buyers and sellers for the best price. Commodity futures exchanges practice the auction market theory via pit trading.

> **Example:** This method requires two or more participants. Person A bids 100. Person B offers 102. Person C can bid 101, offer 101, sell at 100, or buy at 102.
>
> Persons A and B created the market publicly via open outcry. Person C was given the opportunity to narrow the bid and offer or buy or sell the existing quotes.

See: *Blackboard Trading/Board Trading*

Audit Trail

A means of supporting entries in which references may be traced from each point to the original source.

Authorization to Transfer

A document giving a broker authorization to remove by transfer segregated funds from a segregated customer account to meet debit obligations in non-segregated accounts of that client. This action is limited to accounts for the same customer and can occur only when a debt is due. The document must be signed and dated by the customer.

Note: Margin calls outstanding are considered debt obligations.

Average(ing)

An arithmetic mean obtained by adding two or more items and dividing the sum by the number of items.

Example:

Trade Price
600.00
630.00
690.00

$$\text{Average trade price} = \frac{600.00 + 630.00 + 690.00}{3}$$

$$\text{Average trade price} = 640.00$$

In shipping, a loss of ships or cargo or damage to cargo.

Payments made by owners or insurers.

Buying the same commodity at the same or varying prices over price fluctuations.

See: *Averaging Down*
Averaging Up

Averaging Down

Purchasing or selling additional positions as prices decline.

Example:

Jan 20 Long 1 Apr COMEX Gold 394
Jan 22 Long 1 Apr COMEX Gold 393
Jan 24 Long 1 Apr COMEX Gold 390

Averaging can take place over days, as above; over months; or within minutes.

See: *Averaging Up*

Averaging Up

Purchasing or selling additional positions as prices advance.

> **Example:** A trader believes a recent bull trend is about to reverse. The trader picks a point and sells at 390. The market continues strong. A second sale is made at 490, then at 540. Assuming each trade is one contract, the trader's average price of 473.33 is higher than the initial trade. This activity can be executed over minutes, days, or weeks.

Acquiring additional positions (longs or shorts) using paper profits.

Also known as: *Pyramiding*

> **Example:** An individual buys 5,000 bushels of wheat with a contract value of $27,000 and deposits margin of $2,500 for that contract. If the market goes in favor of the client by 10% ($27,000 × .10), $2,700 in paper profits makes it theoretically possible to purchase an additional contract.

See: *Averaging Down*

B

Back Spread

A spread, used by arbitrageurs, with a smaller than normal difference in price in two or more currency or commodity markets.

Example:

Normal Price for a Commodity			
U.S.			$ 90.00
London	£ 50.00	U.S. $ equivalent	100.00

Current Price for the Commodity			
U.S.			$90.00
London	£ 45.00	U.S. $ equivalent	90.00

A trader would Buy London and simultaneously Sell U.S. Assuming the U.S. commodity stays unchanged (at the normal level) and London rises to its normal level, the trader would then Sell London and Buy U.S. No money would be gained or lost on the U.S. trade:

Bought $90.00/Sold $90.00

The London trade would have a gain of £ 5.00 (U.S. equivalent $10.00), resulting in a profit of $10.00.

Bought £ 45/Sold £ 50

Back Month

A calendar month that is active and more than 90 days from the current trading month.

Example:

Active Months	Mar	May	Jun	Jul	Dec
Current Month	Mar				
Back Months				Jul	Dec

Sometimes this term is used to signify a month in which futures trading is taking place with a maturity other than current, spot.

Example:

Active Months	Mar	May	Jun	Jul	Dec
Current Month	Mar				
Back Months		May	Jun	Jul	Dec

See: *Spot Month*

Backwardation

A market in which supplies are currently in shortage, causing the near contract months to sell at premium and distant contract months to sell at discount.

Also known as: *Inverted Market*

Example:

Soybeans	*Sep*	*Nov*	*Jan*	*Mar*
	5.60	5.49	5.40	5.38

Supply and demand outweigh carrying charges (storage and handling) of the normal market.

A basic pricing structure in which the near deliveries cost more than the futures.

The practice of delaying settlement in the London Market. For backwardation, charges are paid by the seller.

See: *Contango/Normal market*

Balance

To compute the net value of an account.

The net debit or credit money remaining in an account.

See Illustration B-1.

To arrange so that one set of elements equals another.

GENERAL LEDGER ACCOUNT

Control Account	*Debit*	*Credit*	*Reconciliation*
Balance Total Customers		$20,000	$20,000 cr
			$20,000 cr

SUBORDINATE LEDGER CUSTOMER ACCOUNTS

Customer A	*Debit*	*Credit*	
Balance		$10,000	$10,000 cr
Customer B	*Debit*	*Credit*	
Balance	$5,000		5,000 dr
Customer C	*Debit*	*Credit*	
Balance		$15,000	15,000 cr
			$20,000 cr

Illustration B-1

The equalization of ledger monies to unrealized profit and loss of open position inventory.