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How Speculators Use Options

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Long Cattle Futures

You are a speculator and believe that cattle prices will go higher. Based on this belief, you buy cattle futures.

August 11	**Buy futures @ 106/cwt**
August 14	**Sell futures @ 109/cwt**
Result: $3/cwt profit	

What if prices instead fell

August 11	**Buy futures @ 106/cwt**
August 12	**Sell futures @ 105/cwt**
Result: $1/cwt loss	

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Short Cattle Futures

You are a speculator and believe that cattle prices will fall. Based on this belief, you sell cattle futures.

August 11	**Sell futures @ 106/cwt**
August 13	**Buy futures @ 104/cwt**

Result: $2/cwt profit

What if prices instead rallied

August 11	**Sell futures @ 106/cwt**
August 12	**Buy futures @ 107/cwt**

Result: $1/cwt loss

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Selling Premium

Speculator believes market will trade sideways or in a specific direction with decreasing volatility

To take advantage of such a market, an option is sold

Speculator expects to keep all or most of premium

Time decay works in favor of the position

Short Soybean Oil Put

August 8

October soybean oil = 50.87

47 BOV put: 105 points (each point = $6 per contract)

Assumptions:

Soybean oil will trade sideways to higher over the next 30 days.

Volatility will fall.

Action:

Sell 47 BOV put @ 110 pts.

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Short Soybean Oil Put

Soybean Oil Futures: 50.00 **Volatility unchanged**

Date	Put Premium
8/22	103 pts.
9/5	62
9/12	39
9/18	17

Long Straddle

Position: Buy a put and buy a call in the same commodity, same expiration month and at the same strike

Total cost = premium paid

Greatest loss = premium paid

Anticipating a big move in either direction with increasing volatility

Speculators are buying volatility when they buy a straddle

Time decay works against the strategy

Long Lean Hog Straddle
at expiration

Futures: 75.32 LHZ

Buy: 76.00 Dec lean hog call @ 385

76.00 Dec lean hog put @ 452

Total cost: 837/cwt

Dec futures	Profit/Loss
66.00	+163
67.63	0
76.00	-837
84.37	0
86.00	+163

Long Corn Straddle

Futures: 5.1825 CZ

Buy 5.20 Call @ .41 1/8

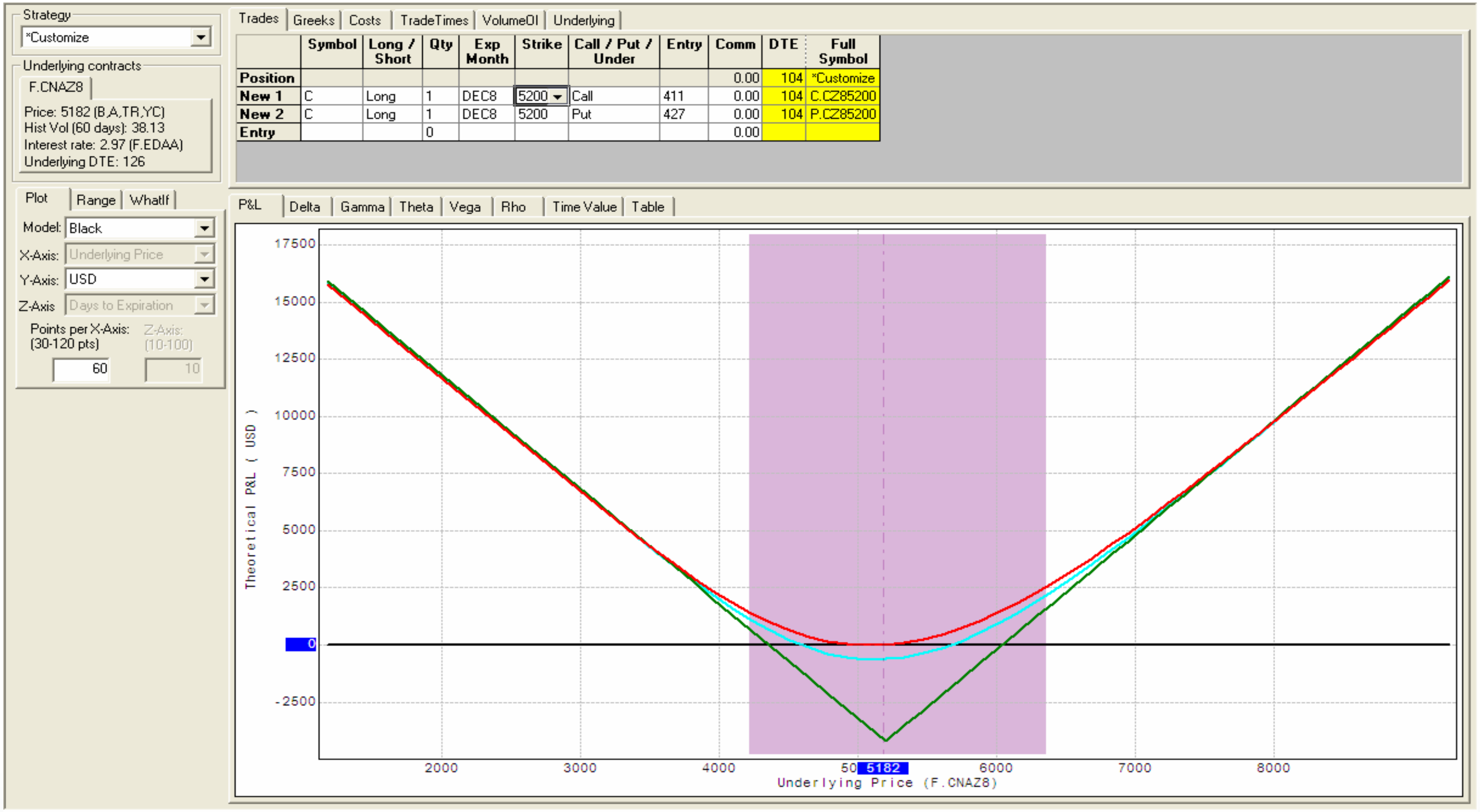
Buy 5.20 Put @ .42 7/8

Total Cost: .84 cents

Breakevens : 6.04 & 4.36

Profit: If corn goes higher or lower by more than .84 and/or volatility increases

Long Corn Straddle
price changes, no change in volatility



	Symbol	Long / Short	Qty	Exp Month	Strike	Call / Put / Under	Entry	Comm	DTE	Full Symbol
Position								0.00	104	*Customize
New 1	C	Long	1	DEC8	5200	Call	411	0.00	104	C.CZ85200
New 2	C	Long	1	DEC8	5200	Put	427	0.00	104	P.CZ85200
Entry			0					0.00		

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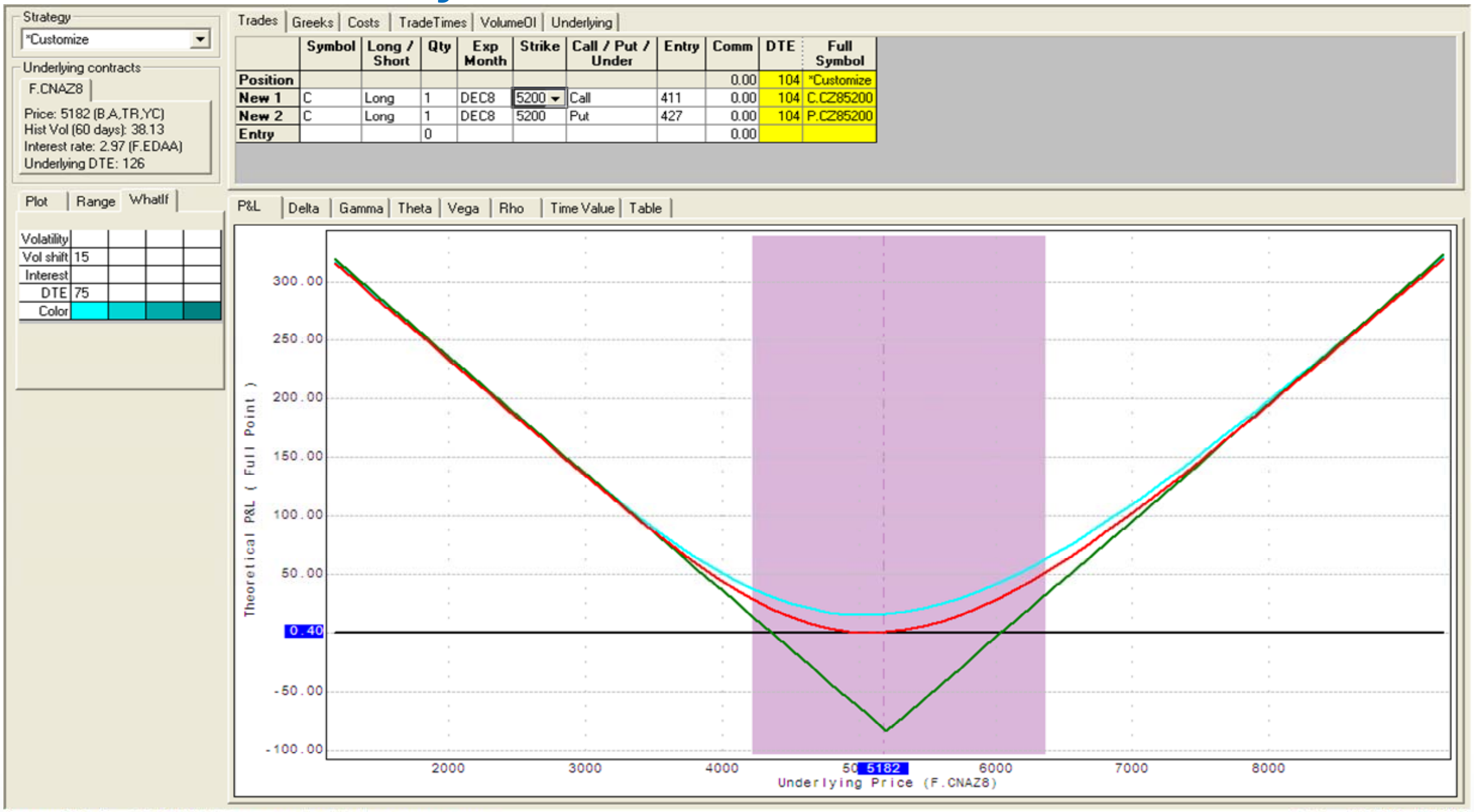
Long Corn Straddle
Increased volatility



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Short Straddle

Position: Sell a put and sell a call in the same commodity, same expiration month and at the same strike

Total gain = premium earned

Loss potential is high & theoretically unlimited

Anticipating little movement in either direction with decreasing volatility

Speculator is selling volatility

Time decay works in favor of the strategy

Short Soybean Meal Straddle
at expiration

Futures: $313 SMZ

Sell: December 310 meal call @ 24.75

December 310 meal put @ 28.05

Premium earned: $52.80/ton

Dec futures	Profit/Loss
200	-57.20
257.2	0
310	+52.80
362.80	0
385	-22.20

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Short Corn Straddle

Futures: 5.1825 CZ

Sell 5.20 Call @ .41 1/8

Sell 5.20 Put @ .42 7/8

Premium earned: .84 cents

Profit: If corn remains stable and/or volatility decreases

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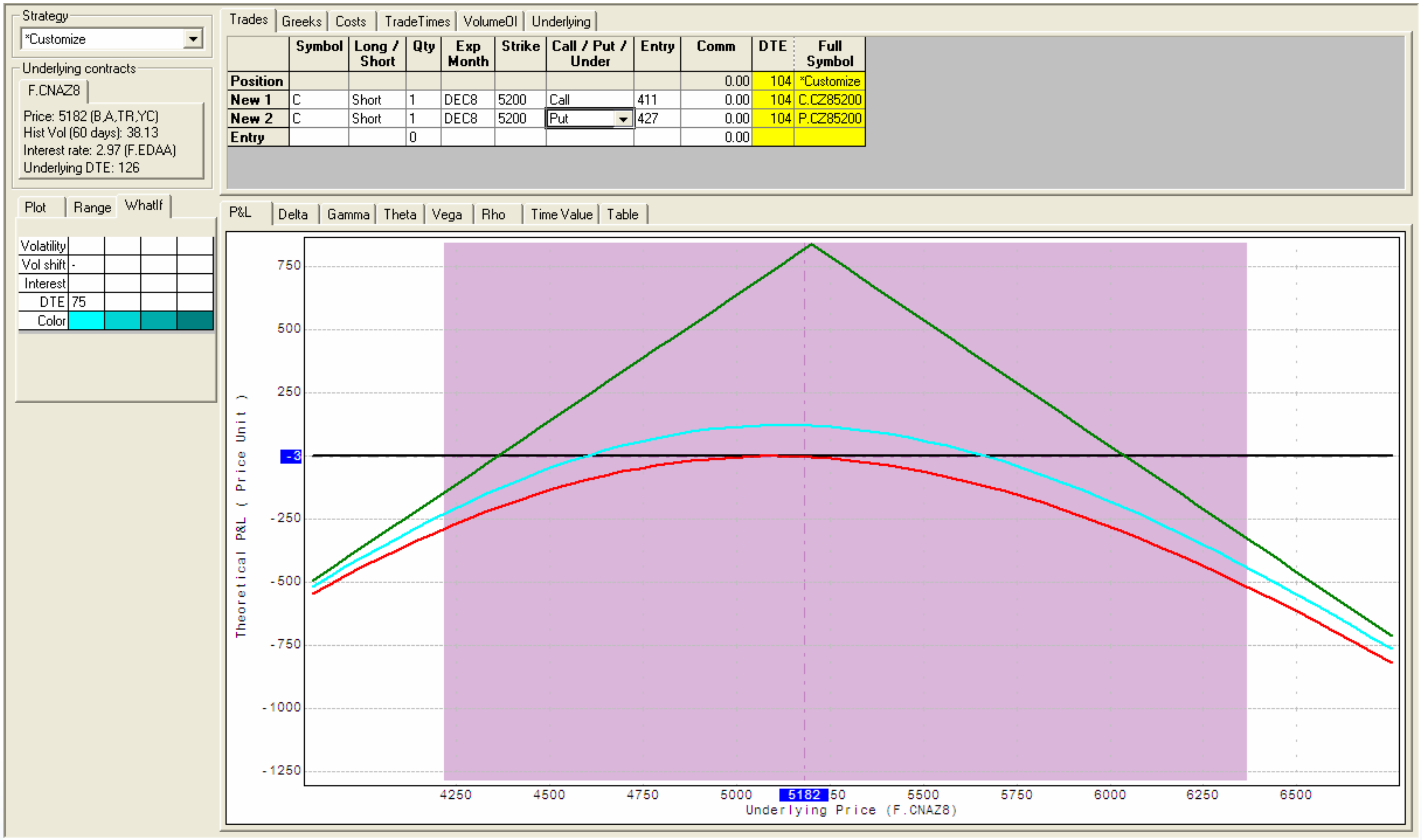
Short Corn Straddle



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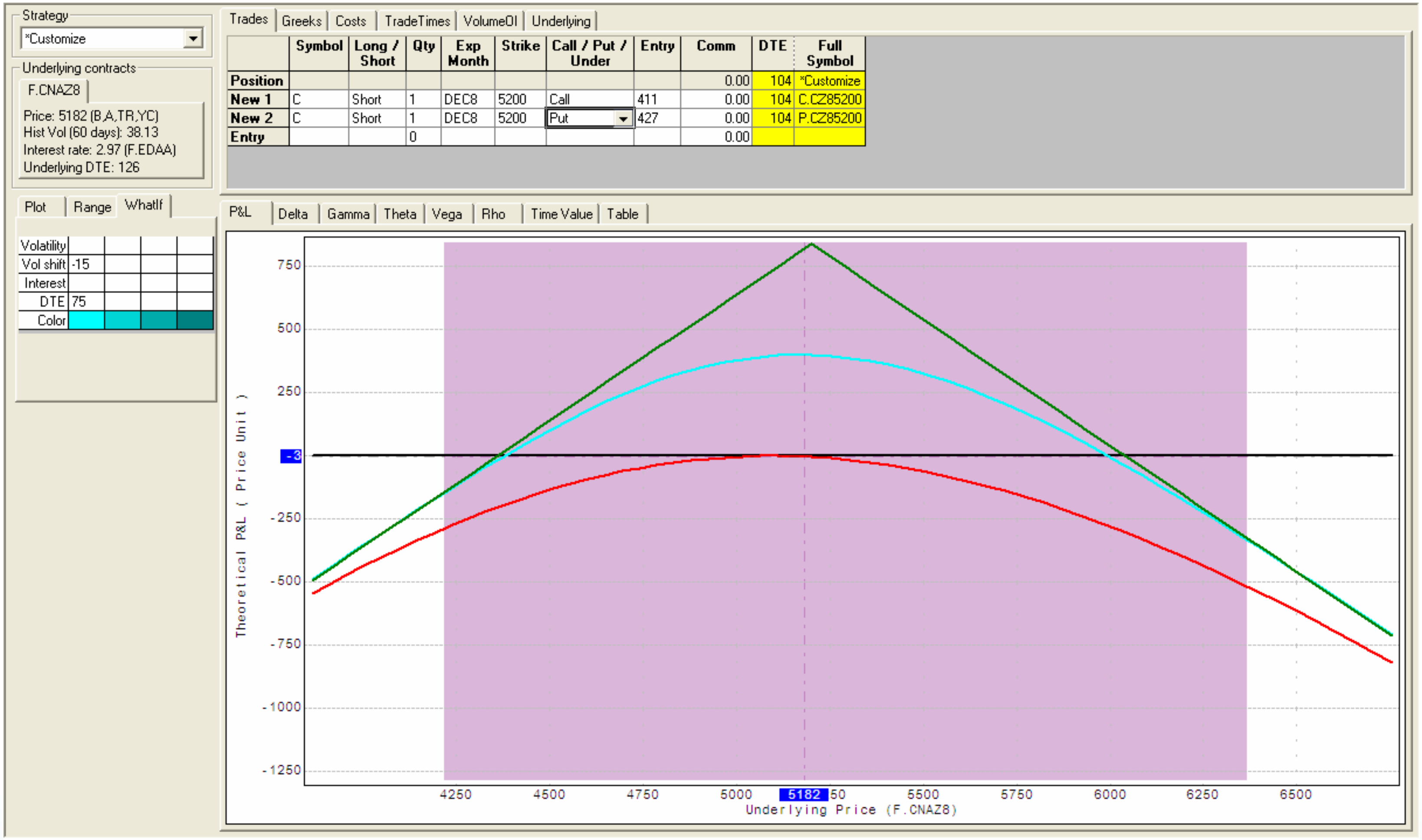
Short Corn Straddle
Decreasing volatility



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Long Strangle

Position: Buy an out-of the money call and out-of-the money put in the same commodity and delivery month

Total cost: Premium paid

Greatest loss: Premium Paid

Anticipating big move in price in either direction and increased volatility

Speculators are buying volatility when they buy strangles

Time decay works against the strategy

A strangle works the same as a straddle but has a lower cost

The reduction in premium has a price—a need for a greater move in price

Long Bean Strangle
at expiration

Futures:	**11.80 SX**
Buy:	**12.60 call @ 59 cents**
	11.00 put @ 53 cents
Total cost:	**1.12 cents**

Nov futures	Profit/Loss
9.00	+.88
9.88	0
11.00	-1.12
12.60	-1.12
13.72	0
14.50	+.78

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Long Wheat Strangle

Futures: 7.9025

Buy 8.30 call @ .53 ¼

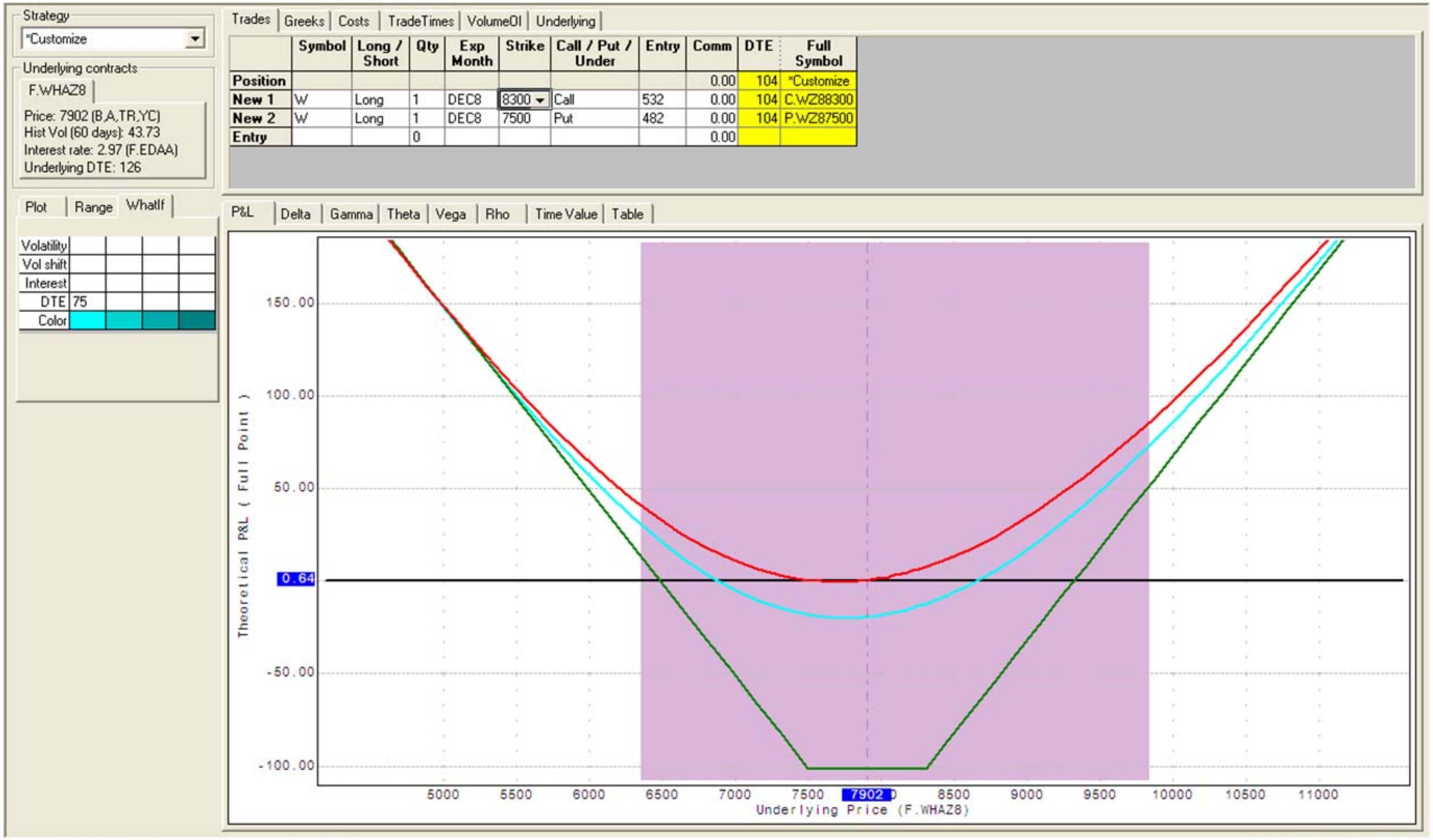
Buy 7.50 put @ .48 ¼

Total cost: 1.01 ½

Breakevens: 9.31 ½ & 6.48 ½

Profit: If wheat goes higher or lower by more than 1.01 ½ and/or volatility increases

Long Wheat Strangle



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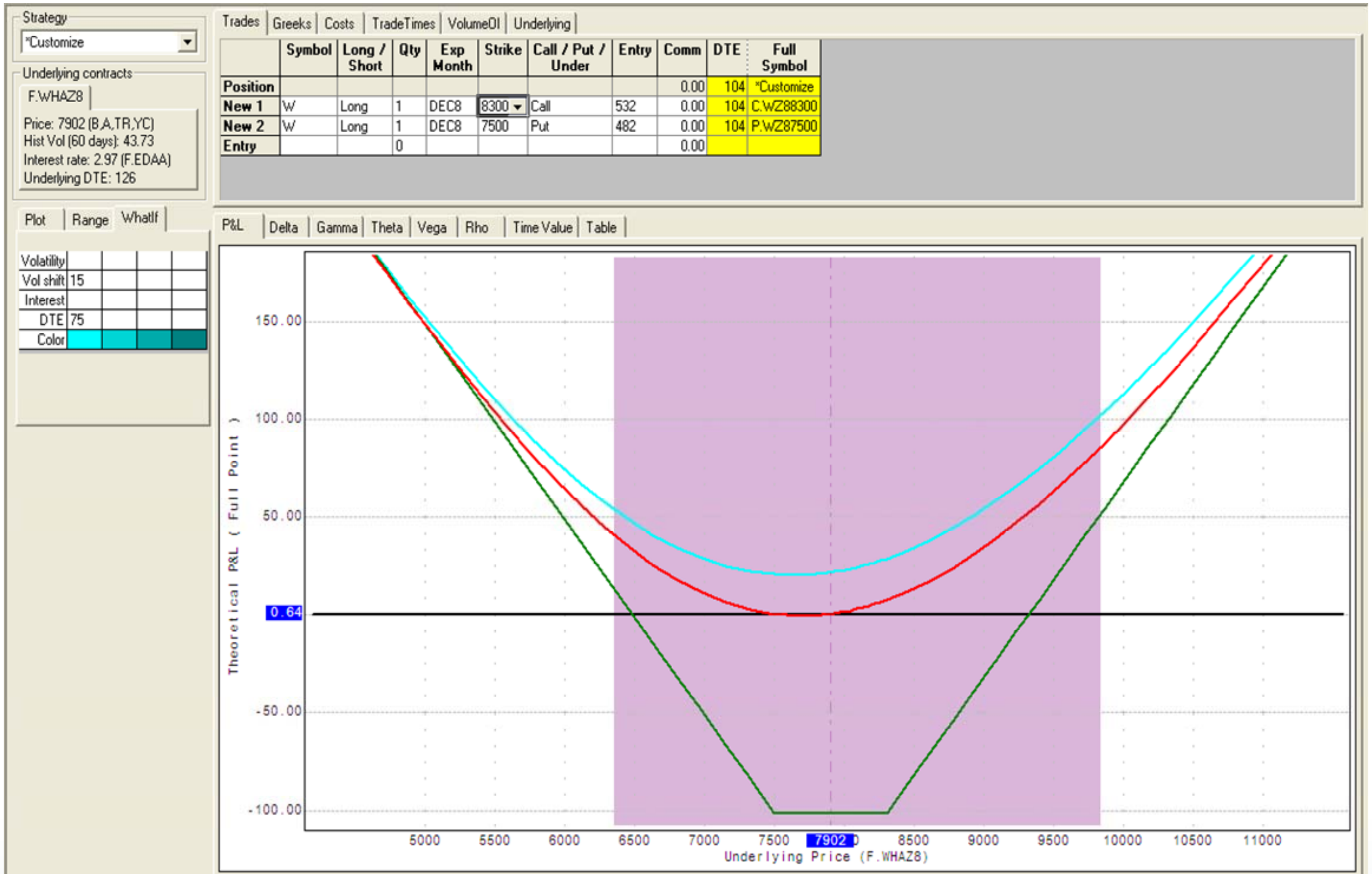
Long Wheat Strangle
With increased volatility



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Short Strangle

Position: Sell an out-of-the money call and an out-of-the money put in the same commodity and expiration month

Total gain = premium earned

Loss potential is high & theoretically unlimited

Anticipating little movement in either direction with decreasing volatility

Speculator is selling volatility

Time decay works in favor of the strategy

Strangle gives the seller a wider margin of safety than the short straddle but earns less premium

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Short Live Cattle Strangle
At expiration

Dec futures: 107.50 LCZ

Sell: 110.00 Dec live cattle call for 300

105 Dec live cattle put for 292 cents

Premium earned: 592

Dec futures	Profit/Loss
98.00	-108
99.08	0
107.5	+592
115.92	0
117.00	-108

Short Wheat Strangle

Futures: 7.9025

Sell 8.30 call @ .53 ¼

Sell 7.50 put @ .48 ¼

Premium earned: 1.01 ½

Profit: If wheat price is stable and/or volatility decreases.

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Short Wheat Strangle

	Symbol	Long / Short	Qty	Exp Month	Strike	Call / Put / Under	Entry	Comm	DTE	Full Symbol
Position								0.00	104	*Customize
New 1	W	Short	1	DEC8	8300	Call	532	0.00	104	C.WZ88300
New 2	W	Short	1	DEC8	7500	Put	482	0.00	104	P.WZ87500
Entry			0					0.00		

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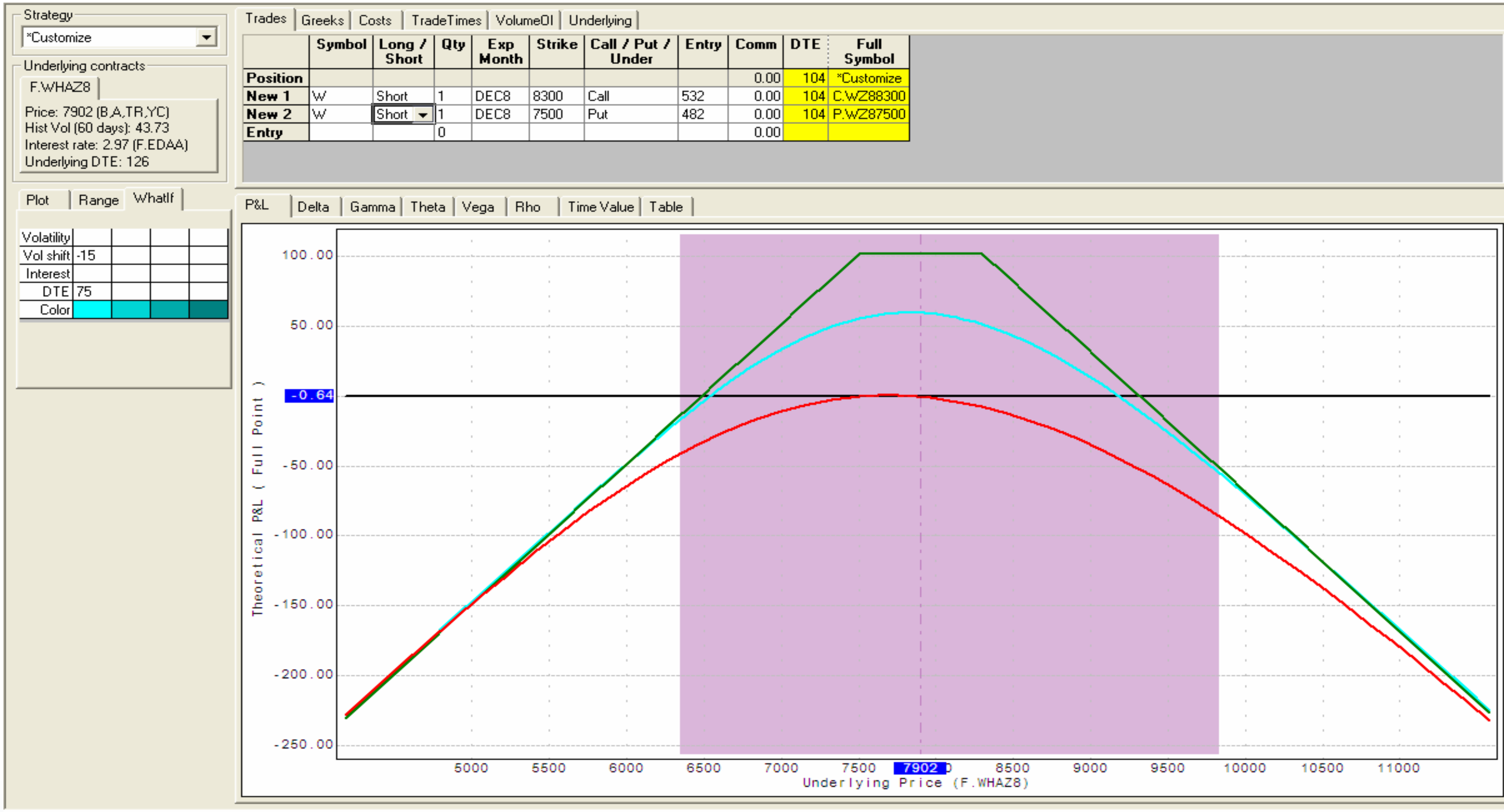
Short Wheat Strangle
Decreasing Volatility



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Delta

The measurement of movement in an options premium relative to a move in the price of the underlying futures. A call's delta is quoted as a positive number and a put's as a negative number.

As the underlying futures price moves, so will the delta. An "at-the-money" option will move approximately one half the value of a futures move. An option "deep-in-the-money" will have a delta near or equal to 1.00 (-1.00). An option "out-of-the-money" will have a delta approaching zero as it continues to move in that direction.

Trading in a Price Range

You believe that wheat prices will trade in a range and volatility will remain stable.

Strategy:

Buy futures

Buy puts

Projected range:

WH: 7.91

WH: 30 cents range for next 90 days

$7.80 - 8.10

August 8

Action:

Buy 100 March wheat 7.80 puts @ 72 cents

delta = 38

Buy 38 March wheat futures @ 7.91

Will manage position by periodically adjusting futures to the option delta

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August 15

March wheat = $7.85

March 7.80 put = 84 cents

delta = 42

Action:

Buy 4 March futures @ $7.85

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August 25

March wheat = $8.00

March 7.80 put = 75 cents

delta = 40

Action:

Sell 2 March wheat @ $8.00

September 5

March wheat = $7.80

March 7.80 put = 81 cents

delta = 45

Action:

Buy 5 March wheat @ $7.80

September 25

March wheat = $8.10

March 7.80 put = 64 cents

delta = 38

Action:

Sell 7 March futures @ $8.10

October 1

March wheat = $7.95

March 7.80 put = 70 cents

Action:

Exit trade

Sell 100 March 7.80 puts @ 70 cents

Sell 38 March wheat @ $7.95

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Futures Activity

Buy:

38 @ 7.91		
4 @ 7.85		
5 @ 7.80	average buy	
	$7.8925	

Sell:

2 @ 8.00		
7 @ 8.10	average sell	
38 @ 7.95	$7.975	

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Total Profit

Futures:

- Average purchase price: 7.89 ¼
- Average sale price: 7.97 ½
- Net gain: 8 ¼ cents per bu.
- 8.25 x $50 x 47 contracts = $19,387.50 profit

Options :

Bought @ 72, sold @ 70 cents

- Net loss: 2 cents per bu.
- 2 x $50 x 100 contracts = $10,000 loss

Net gain $9,387.50

Potential Problems

1. Volatility decreasing
2. Time decay

•Need to manage this strategy - adjusting futures position to delta.

•Adjust position based on your parameters

•Balance between opportunity and brokerage fee

Sue speaks on a wide variety of subjects including:

Ag Cash Markets

- World Markets Fundamentals
- Processing
- Grain Flow/Transportation
- Cash Grain Trade
- Grain Merchandising Tools
- Grain Contracts
- Ag Policy
- Major Market Reports
- USDA Supply & Demand Report Analysis

Futures & Options Markets, Hedging

- History & Development of Futures
- Futures Organization & Regulation
- Clearing & Margining Process
- Hedging Fundamentals & Basis Trading
- Spreads
- Hedging & Spread Applications for the Merchandiser
- Market Analysis
- Options
- Options Applications, both introductory and advanced

Sue Goll, Agricultural Consultant

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Sue Goll is an agricultural consultant with over 25 years of experience as a cash grain merchandiser and futures industry participant. She worked at A.E. Staley for over six years as a grain merchandiser, trading beans, meal and corn out of Des Moines, Iowa, and Lafayette, Indiana.

While in Lafayette, Sue oversaw grain merchandising, truck and rail logistics and originated corn for two wet milling plants. She also handled offsetting hedge and spread strategies for the Lafayette futures position.

Sue spent the next two years as a farm market advisor for a farm advisory firm assisting producers in marketing their crops.

She joined the Chicago Board of Trade in 1989. During her six years with the exchange, Sue traveled worldwide teaching the use of agricultural futures and options markets. Additionally, she specialized in the development of educational materials and booklets for the commercial hedger.

Sue has been self-employed as a consultant since 1995. In this capacity, she works with domestic and foreign businesses teaching cash/physical market fundamentals, the practical use of futures and options, and writing technical materials.

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