

## A

### **American-Style Option**

An option contract that may be exercised at any time between the date of purchase and the expiration date. Most exchange-traded options in the United States are American-style.

### **Anticipatory Hedge**

A trader expects to make a spot transaction at a future date and opens a futures position now to protect against a change in the spot price.

### **Arbitrage**

The simultaneous purchase of one asset against the sale of the same or equivalent asset in two different markets to create a risk less profit due to price discrepancies.

### **Arbitrage bands**

The band around the no-arbitrage price, within which arbitrage transactions are not worth while.

### **Arbitrage risk**

While the arbitrage transaction is risk less in theory, in practice, some risks may be present.

### **Assignment**

The receipt of an exercise notice by an option writer (seller) that obligates him to sell (in the case of a call) or purchase (in the case of a put) the underlying security at the specified strike price.

### **Ask price**

The price at which the market maker is willing to sell. Also called the offer price.

### **At-The-Money**

An option is at-the-money if the strike price of the option is equal to the market price of the underlying security.

## B

### **Backwardation**

This occurs when the spot price exceeds the current price of a futures contract. The opposite of contango.

### **Basis**

The difference between the cash price of a financial instrument and the price of a particular futures contract relating to that instrument. Also known as a crude basis or simple basis.

**Basic risk**

The possibility that the value of the basis will change over time.

**Bear market**

A market in which prices are declining.

**Bear spread**

A calendar spread designed to profit in a bear market.

**Beta**

A measure of responsiveness of a security or portfolio to movements in the stock market as a whole. Measures systematic risk.

**Bid-ask bounce**

In the absence of new information, the transaction prices for a security will fluctuate between the bid and the ask price, depending on whether the trade was initiated by a buyer or a seller.

**Bid-ask spread**

The difference between the ask price and bid price.

**Bid price**

The price at which a market maker is willing to buy.

**Broker**

A person who acts as an agent for others in buying and selling futures contracts in return for a commission.

**Bull market**

A market in which prices are rising.

**Bull spread**

A calendar spread designed to profit from a bull market.

**Buy-and-hold**

A passive strategy in which a trader buys a security (or portfolio), which is then held for a period of time without revision.

**Buy on close**

To buy at the end of a trading session at a price within the closing range.

**Buy on opening**

To buy at the beginning of a trading session at a price within the opening range.

**C**

**Calendar spread**

The simultaneous purchase and sale of futures contracts for different delivery months of the same financial instrument. Also called an intracommodity spread, a horizontal spread or a time spread.

**Capped-style option**

A capped option is an option with an established profit cap. The cap price is equal to the option's strike price plus a cap interval for a call option or the strike price minus a cap interval for a put option. A capped option is automatically exercised when the underlying security closes at or above (for a call) or at or below (for a put) the Option's cap price.

**CAPM**

Capital Assets Pricing Model. The equilibrium expected return on an asset depends on the riskless interest rate, the expected return on the market and the asset's beta (B) value.

**Carrying charges**

The total cost of carrying an asset forwards in time, including storage, insurance and financing costs.

**Cascade theory**

The stock market crash of October 1987 was caused by a fall in stock market price, which led portfolio insurers to sell index futures, resulting in a drop in their price, and, via index arbitrage, a further fall in stock market prices, etc.

**Cascade theory**

An arbitrage transaction where the trader holds a long position in the underlying asset and a short position in the corresponding futures contract.

**Cash market**

In commodities markets this term is used to refer to the market in a particular grade and location of the underlying asset. For index futures there is only one underlying grade and location, and so the cash market is synonymous with the spot market.

**Cash settlement**

At delivery time, instead of the physical transfer of the underlying asset, there is a final marking to the market at the EDSP and the positions are closed out.

**CFTC**

Commodity Futures Trading Commission. An independent US federal agency which has regulated futures trading in the United States since 21st April 1975.

**Circuit breaker**

A trading halt when the price movement exceeds some present limit.

**Class of options**

Option contracts of the same type (call or put) and Style (American, European or Capped) that cover the same underlying security.

**Clearing house**

An organisation connected with futures exchange through which all contracts are reconciled, settled, guaranteed and later either offset or fulfilled through delivery or cash settlement. Its function is to manage the margin and delivery systems, as well as to guarantee performance of exchange traded contracts.

**Clearing member**

A member of the clearing house.

**Close**

The time period at the end of the trading session during which that day's settlement price is determined.

**Closing price**

The last price of the trading period for a security.

**Closing purchase**

A transaction in which the purchaser's intention is to reduce or eliminate a short position in a given series of options.

**Closing sale**

A transaction in which the seller's intention is to reduce or eliminate a long position in a given series of options

**Commission (or round trip)**

A fee charged by a broker to a customer when a position is liquidated.

**Commodity pool operator**

The firm managing a commodity pool. This terminology is common in the U.S.

**Commodity trading adviser**

Professional traders who conduct individually managed accounts on behalf of investors. This terminology is common in the U.S.

**Composite hedge**

A single spot position is hedged using a number of different futures.

**Compulsory close-out**

A customer's open positions in futures contracts are squared-up by the member firm holding the account or the Clearing House, usually after the customer fails to meet margin calls. Also see Forced liquidation.

**Condor spread**

A bull (bear) calendar spread in two different maturities is matched by a bear (bull) calendar spread in another two maturities. This requires there to be at least four outstanding maturities.

**Contagion**

Mistakes in setting prices in one market are transmitted to another.

**Contango**

This exists when the spot price is less than the current price of a futures contract. The opposite of backwardation.

**Continuous compounding**

Interest is accrued continuously rather than at discrete intervals. The interest is assumed to be added to the capital sum and so interest is then also payable on the interest received.

**Contract**

The standard unit of trading for futures markets.

**Contract month**

The month in which futures contracts may be satisfied by making or accepting delivery.

**Contract multiplier**

The monetary value that is multiplied by the index value to determine the market value of the futures contract.

**Contract specification**

The standard terms of the futures contract to be traded. e.g. size of the contract, tick size, settlement and margining methodology, trading times, delivery procedures.

**Convergence**

The movement to equality of the spot and futures prices as the delivery date approaches.

**Corner**

A few people gain control of all available supplies of the underlying asset.

**Cost of carry**

The cost of holding a stock of the underlying e.g. the costs of storing, insuring and financing the asset.

**Cost of carry price**

The futures prices given by the cost of carrying an equivalent spot position until delivery.

**Counterparty**

The other party (buyer or seller) to a transaction.

**Counterparty risk**

The risk the counterparty will not fulfil the terms of the contract. Also called default risk.

**Covered call option writing**

A strategy in which one sells call options while simultaneously owning an equivalent position in the underlying security or strategy in which one sells put options and simultaneously is short an equivalent position in the underlying security.

**Cross hedge**

Hedging a risk is one asset by initiating a position in a different but related asset.

**Crossing**

A situation where the broker acts for both the buyer and seller. All cross trades must be transacted on the trading floor, or through the screen market. This is currently not allowed by SEBI in India.

**Crowd**

The group of people standing in the futures pit.

**Cum dividend**

A share is cum dividend when the purchaser receives the next dividend payment.

**D**

**Day order**

An order to trade futures contracts that automatically expires at the end of that day's trading session.

**Day trades**

Trades that are opened and closed on the same day.

**Default risk**

The risk that the counterparty will fail to meet their obligations under a contract.

**Deferred**

Another term for "back months." Delivery The tender and receipt of an actual commodity or financial instrument, or cash in settlement of a futures contract.

**Deferred contract**

Futures contracts other than the near contract. Also known as back contract.

**Delivery**

The transfer of ownership of an actual financial instrument, or final cash payment in lieu thereof, in settlement of a futures contract under the specific terms and procedures established by the exchange. Also see settlement.

**Delivery day**

The day on which the futures contract matures. Also known as expiry day.

**Delivery month**

The calendar month on which the futures contract matures, resulting in delivery or cash settlement of the specified financial instrument. Also known as expiration month.

**Delivery price**

The price fixed by the clearing house at which deliveries on futures contracts are invoiced. Also known as the expiry price or the settlement price.

**Derivative**

A financial instrument designed to replicate an underlying security for the purpose of transferring risk.

**Discrete compounding**

Interest payments are made periodically. The interest is assumed to be added to the capital sum and so interest is then payable on the interest received.

**Double auction market**

This occurs when the price is determined by competitive bidding between both buyer and sellers, as in futures markets.

**Dual capacity**

A floor trader is allowed to trade on his or her own behalf, as well as an agent for others.

**Dual listing**

Futures contracts on the same underlying asset are traded on more than one exchange.

**Dynamic hedge**

An investment strategy in which a long position in shares is hedged by selling futures. The futures position is adjusted frequently so that it replicates a purchased put option.

**E**

**Efficient frontier**

Feasible combinations of expected profit and risk which, for each level of risk, have maximum profit.

**Eligible margin**

The cash or other collateral, which may be accepted as cover for margin obligations.

**EDSP**

Exchange Delivery Settlement Price. This is the price at which the delivery or cash settlement takes place, expressed in index points. This terminology is common in the U.S.

**Equity options**

Options on shares of an individual common stock.

**European-style options**

An option contract that may be exercised only during a specified period of time just prior to its expiration.

**Equity swap**

A contract between two parties by which they swap the returns from an equity portfolio and an investment at a fixed or variable interest rate.

**Excess return**

The return on a security beyond that which could have been earned on riskless asset.

**Ex-dividend**

A share is ex-dividend when the purchaser does not receive the next dividend payment.

**Exercise**

To implement the right under which the holder of an option is entitled to buy (in the case of a call) or sell (in the case of a put) the underlying security.

**Exercise settlement amount**

The difference between the exercise price of the option and the exercise settlement value of the index on the day an exercise notice is tendered, multiplied by the index multiplier.

**Execution risk**

The risk that prices may move between the time an order is initiated and executed.

**Expiration**

The date that any futures contract (or option) ceases to exist.

**Expiration cycle**

An expiration cycle relates to the dates on which options on a particular underlying security expire. A given option will be assigned to one of three cycles, the January cycle, the February cycle or the March cycle. LEAPS are not included in this cycle.

**Expiration date**

Date on which an option and the right to exercise it, cease to exist.

**Expiration time**

The time of day by which all exercise notices must be received on the expiration date.

**F****Fair value**

The no-arbitrage price of a futures contract. Also known as theoretical value.

**Far contract**

The future that is furthest from its delivery month i. e. has the longest maturity.

**Fill or kill order**

An order to trade futures contracts which must be executed immediately. If not it is cancelled.

**Financial engineering**

The process of designing new financial instruments, especially derivative securities.

**Float capitalisation**

The value of that portion of the firm's equity that is available for trading, and so excludes shares in the hands of controlling investors.

**Floor broker**

An exchange member who is paid a fee for executing orders for Clearing Members or their customers. A Floor Broker executing orders must be licensed by the exchange he is working on.

**Floor trader**

An exchange member who generally trades only for his/her own account or for an account controlled by him/her. Also referred to as a "local."

**Forced liquidation**

A customer's open positions in futures contracts are offset by the brokerage firm holding the account, usually after the customer fails to meet margin calls. Also called compulsory close-out.

**Forward contract**

An agreement between two parties to trade an asset at a specified future date and price. This is an OTC product.

**Forward months**

Futures contracts other than the near contract.

**Front running**

Brokers trade on their own behalf, ahead of their customers order's. This was only banned in Japan in December 1992.

**Fundamental analysis**

The application of economic analysis to publicly available information to predict price movements.

**Futures commission merchant**

A firm or person engaged in soliciting or accepting and handling orders for the purchase or sale of futures contracts, subject to the rules of a futures exchange and, who, in connection with solicitation or acceptance of orders, accepts any money or securities to margin any resulting trades or contracts. The FCM must be licensed by the CFTC.

**Futures contract**

A legal, transferable standardised contract that represents an agreement to buy or sell a quantity of a standardised asset at a predetermined delivery date. This is an exchange-traded product.

**Futures fund**

They raise money from investors and pool this capital into a fund, which is invested in futures contracts. A popular form is a 90/10 fund. Also known as commodity pool.

**Futures and options fund**

U K unit trusts that can invest up to 10 percent of their funds in futures and options.

**Futures option**

An option written on a futures contract.

**G**

**Geared futures and options fund**

U K unit trusts that can invest up to 20 percent of their funds in futures and options and have the potential to lose all the money in the fund.

**Generalised hedge**

A number of different spot positions are hedged using a variety of different futures.

**H**

**Hedge**

A spread between a spot asset and a futures position that reduces risk.

**Hedge portfolio**

The portfolio of shares whose risk is being hedged away.

**Hedge ratio**

The number of futures contracts bought or sold divided by the number of spot contracts whose risk is being hedged.

**Hedging**

The purchase or sale of futures contracts to offset possible changes in the value of assets or cost of liabilities currently held, or expected to be held at some future date.

**Holder**

The party who purchased an option.

**Holding period**

The time period over which an investment is held.

**I****Initial performance bond**

The funds required when a futures position (or short options on futures position) is opened. Sometimes referred to as initial margin)

**Implementation risk**

The risk that new information may arrive after an investors has decided to trade and before the order is submitted.

**Implied volatility**

The variance of returns on an asset that is implied by equating the observed and theoretical prices of an option on that asset.

**Index fund**

An institutional investment portfolio that aims to replicate the performance of a chosen market index.

**Index option**

An option written on a stock index.

**Index participation**

The trading of baskets of shares corresponding to those in some specified market index. The buyer of the index participation pays immediately in exchange for a promise by the seller to deliver the shares (or their cash equivalent) at one of a number of subsequent dates, chosen by the buyer. Also know as an Exchange Traded Fund (ETF).

**Infrequent trading**

If trading is not continuous it is infrequent, infrequent trading may be either non-synchronous trading or non-trading.

**Initial margin**

The 'good faith' deposit of the cash or securities which a user of futures market must make with his or her broker when purchasing or selling futures contracts, as a guarantee of contract fulfilment.

**Inside information**

Private and confidential information, usually acquired through a position of trust, that is likely to have an impact on security prices when made public.

**Insider trading**

Dealing on the basis of inside information.

**Intercommodity spread**

The simultaneous purchase and sale of futures contracts in different financial instruments.

**Intermarket spread**

A spread involving futures contracts traded on different exchanges.

**Intramarket spread**

A spread involving future contracts traded on the same exchange.

**Invertmarket spread**

A market in which the price of a stock index futures is higher the closer is the contract to delivery.

**In-the-money**

A call option is in-the-money if the strike price is less than the market price of the underlying security. A put option is in-the-money if the strike price is greater than the market price of the underlying security.

**Intrinsic value**

The amount by which an option is in-the-money.

## L

**LEAPS**

Long-Term Equity Anticipation Securities are long-term stock or index options. LEAPS are available in two types, calls and puts. They have expiration dates up to three years in the future.

**Leg**

One of the two positions constituting a spread.

**Leverage effect**

When the price of a share rises and the value of the firm's outstanding debt is fixed, the ratio of debt to equity falls, i.e. its leverage (or gearing) falls. This makes return on the share less risky. A reverse argument applies for price falls.

**Lifting a leg**

Liquidating one side of a spread or arbitrage position prior to liquidating the other side. Also called 'legging out'.

**Limit down**

This occurs when the futures price has moved down to the lower price limit.

**Limit move**

The price has increased or decreased by the maximum amount permitted by the price limits.

**Limit order**

An order to buy or sell at a specific price (or better), to be executed when and if the market price reaches the specified price.

**Limit order book**

A list of the outstanding limit orders.

**Limit up**

This occurs when the price has moved up to the upper price limit.

**Liquidation**

Any transaction that offsets or closes out a previously established long or short position; also known as buying in or covering.

**Liquidity**

The degree to which a market can accommodate a large volume of business without moving the price, i.e. market impact.

**Local**

A floor trader who executes trades on his or her own account in the open outcry system.

**Long**

A market position established by buying one or more futures contracts not yet close out through an offsetting sale; the opposite of shot.

**Long hedge**

A hedge involving a long futures position and a short spot position.

**Long position**

An investor's position where the number of contracts bought exceeds the number of contracts sold. He is a net holder.

**Long the basic**

The purchase of the underlying asset and sale of contracts in the corresponding futures contract.

## M

**Macro hedging**

A firm hedges the combined exposure of all its assets and liabilities. See also micro hedging.

**Maintenance margin**

The minimum amount which a person is required to keep in their margin account.

**Margin**

A deposit of funds to provide collateral for an investment position. See also initial margin, variation margin and maintenance margin.

**Margin call**

A request for the payment of additional funds into a person's margin account.

**Mark-to-market**

The daily adjustment of margin accounts to reflect profits and losses.

**Market capitalisation**

This is calculated by multiplying the number of a company's shares issued by the share price.

**Market efficiency**

The degree to which current prices reflect a set of information.

**Market-if-touched order**

An order to buy futures contracts which becomes a market order if the market reaches a specified price below the current price, or to sell if the market price reaches a specific level above the current price. Opposite of a stop order.

**Market maker**

A dealer who makes firm bids and offers at which he or she will trade.

**Market-on-close order**

An order to buy or sell at a price as close as possible to the closing price for that day.

**Market-on-open**

A market order to be executed during the opening.

**Market order**

An order to buy or sell for immediate execution at the best obtainable price.

**Market portfolio**

A market value weighted portfolio consisting of every share traded on the exchange.

**Market risk**

The possibility of gain or loss due to movements in the general level of the stock market. Also see systemic risk.

**Marking to the market**

The daily revaluation of open positions to reflect profits and losses based on closing market prices at the end of the trading day.

**Matching**

The process by which buy and sell transactions are reconciled, before being passed to the clearing house.

**Maturity**

The length of time before delivery.

**Minimum price fluctuation**

Smallest increment of price movement possible in trading a given contract, more commonly referred to as a "tick."

**Maximum price fluctuation (futures)**

The maximum amount the contract price can change, up or down, during one trading session, as stipulated by Exchange rules.

**Micro hedging**

A firm hedges only specific transactions rather than all its assets and liabilities. See also macro hedging.

**Minimum price movement**

The smallest possible price change. See also point and tick size.

**Mispricing**

It usually refers to the actual less the no-arbitrage futures price, and may be deflated by either the spot price or the no-arbitrage futures price. In a few cases the mispricing incorporates transactions costs.

**Momentum trader**

A trader who sells when the market falls and buys when the market rises. This behaviour tends to amplify price movements. Also known as a positive feedback trader.

**N**

**National futures association**

A self-regulating US body, which registers and regulates those employed in the futures brokerage industry.

**Naïve hedge ratio**

A one-for-one hedge ratio.

**Near contract**

The future that is nearest to its delivery month i.e. has the shortest maturity.

**Net position**

The difference between the long and short open positions in any one future held by an individual or group.

**Non-synchronicity**

The stock trades at least once every interval, but not necessarily at the close of each interval. See non-trading.

**Non trading**

The stock does not trade during every interval. See non-synchronicity.

**Normal backwardation**

This occurs when the expected price of a futures contract at delivery exceeds the current price of the future.

**Normal market**

A market in which the price of a stock index futures contract is lower the closer is the contract to delivery.

**Novation**

The legal word for the conversion of a futures contract between a buyer and seller into two separate contracts, each with the clearing house as counterparty.

**O****Odd lot**

A quantity of shares that does not correspond to that in which trading normally takes place.

**Offer**

The price at which an investor is willing to sell a futures or options contract. Offset buying if one has sold, or selling if one has bought, a futures or options on futures contract.

**Open interest**

The cumulative number of either long or short contracts which have been initiated on an exchange, and have not been offset.

**Open outcry**

The method trading on many futures exchanges whereby bids and offers are audible to all other participants on the floor of the exchange (or pit) in a competitive public action.

**Open positions**

Contracts, which have been initiated and are not yet, offset by a subsequent sale of purchase, or by making or taking delivery.

**Opening Purchase**

A transaction in which the purchaser's intention is to create or increase a long position in a given series of options.

**Opening sale**

A transaction in which the seller's intention is to create or increase a short position in a given series of options.

**Original margin**

The initial margin required to cover a new futures position.

**Out-of-the-money**

A call option is out-of-the-money if the strike price is greater than the market price of the underlying security. A put option is out-of-the-money if the strike price is less than the market price of the underlying security.

**Out trade**

A trade for which there is not a matching record by the two parties. This may be because the price, quantity, maturity, counter party or sides (long – short) fail to match.

**Overbought**

A view that the market price has risen too strictly in relation to the underline fundamental factors.

**Overnight trade**

A trade which is not liquidated on the same day on which it was established.

**Overpriced**

The actual futures price exceeds the no-arbitrage futures price.

**Oversold**

A view that the market price has declined too steeply in relation to the underlying fundamental factors.

**Over-the-counter (OTC) market**

A market where dealing does not take place at an organised exchange.

**P****Perfect hedge**

A hedge where the change in the value of the future contracts is identical to the change in the value of the other asset or liability.

**Physical delivery**

Settlement of a futures contract by the supply or receipt of the asset underlying the contract.

**Pit**

An octagonal or hexagonal area on the trading floor of an exchange, surrounded by a tier of steps upon which traders and brokers stand while executing futures trades in the open outcry system.

**Point**

This can mean the minimum permissible price change, or it can mean a price change of 100 basis points. For index point are simply the units of measurement of the index. Currently for the FT-SE 100 the minimum price movements is 0.5 index points.

**Portfolio insurance**

An investment strategy employing various combinations of shares, options, futures and debt that is designed to provide a minimum or floor value to the portfolio.

**Position**

A market commitment. Also see net position.

**Position limit**

A restriction on the maximum number of contracts that can be held by a single trader at any one time.

**Position trading**

A trading strategy in which a position is held for longer than one day.

**Premium (options)**

An options price has two components. They are the intrinsic value and time value. Premium is often referred to as time value.

**Premium (futures)**

The excess of one futures contract price over that of another, or over the cash market price. Or, The amount agreed upon between the purchaser and seller for the purchase or sale of a futures option. Remember that purchasers pay the premium and sellers (writers) receive the premium.

**Price discover**

The process by which a market (usually the futures market) reflects new information before another related market (usually the spot market).

**Price limit**

The maximum and minimum prices, as specified by the exchange, between which transactions may take place during a single trading session.

**Price range**

The difference between the highest and lowest pricing during a given period.

**Price relative**

The price at time  $t + 1$  divided by the price at time  $t$ .

**Programme trading**

The simultaneous trading of a basket of shares as part of a plan or strategy. The NYSE definition requires the simultaneous trading of at least fifteen stocks with a total value of over \$1 million.

**Punching and settlement price**

A manipulator first establishes a long (short) position in index futures, and then buys (sells) shares to push the final settlement price up (down).

**Put**

An option contract that gives the holder the right to sell the underlying security at a specified price for a fixed period of time.

**Pyramiding**

The use of profits on a previously established position as margin for adding to that position.

**Q**

**Quasi-futures contract**

This is the same as a futures contract, except that the payments of variation margin do not involve the full daily price change. Instead, the trader pays (or receives) each day the present value of the daily price change if it were paid on delivery day; a smaller sum.

**Queue**

The sequence of potential arbitrageurs, in order of increasing transactions costs.

**R**

**Rally reaction**

A decline in prices following an advance. The opposite of rally. An upward movement of prices following a decline; the opposite of a reaction.

**Random walk**

The theory that changes in the variable (for example, share returns) are at random; that is, they are independently and identically distributed over time.

**Realised bid-ask price**

The difference between the prices at which scalpers have bought and sold.

**Reportable position**

The number of futures contracts above which one must report daily to the exchange or the CFTC the size of the position by delivery month and purpose of trading.

**Reserve cash and carry**

An arbitrage transaction where the trader holds a short position in the underlying asset and a long position in the corresponding futures contract.

**Risk premium**

The additional return risk-averse investors require for assuming risk.

**Roll over**

Liquidation for a futures position, and the establishment of a similar position in a more distant delivery month. This is also called a switch. When a hedger switches their futures position to a more distant delivery month this can be called 'rolling the hedge forwards'.

**Round lot**

A quantity of shares that corresponds to that in which trading normally takes place.

**Round trip/round turn**

The purchase (sale) of a futures contract and the subsequent offsetting sale (purchase). Transactions costs are normally quoted on a 'round trip' basis.

**S****Scalp**

To trade for small gains, normally by establishing and liquidating a futures position quickly, often within minutes, but always within the same day.

**Scanning range**

The largest price movement in the underlying security for which the clearing house requires cover.

**SEBI (Securities and Exchange Board of India)**

The regulatory body for all participants in the securities and derivatives markets in India.

**SEC (Securities and Exchange Commission)**

A federal agency charged with the regulation of all US equity and options markets.

**Security market line**

A line showing the relationship between a security's beta and its expected return.

**Series**

All option contracts of the same class that also have the same unit of trade, expiration date and strike price.

**Settlement**

The process by which clearing members close positions.

**Settlement price**

The price which the clearing house uses to determine the daily variation margin payments. It may differ from the price of the last transaction.

**Sharpe's measure**

A measure of the risk adjusted performance of an investment. It is calculated as the excess return on the investment divided by the standard deviation of investment returns.

**Short**

A market position established by selling one or more futures contracts not yet closed out through an offsetting purchase in anticipation of falling prices; the opposite of long.

**Short hedge**

A hedge involving a short futures position and a long spot position.

**Short position**

An investor's position where the number of contracts sold exceeds the number of contracts bought. The person is a net seller.

**Short sale**

A trader sells shares he or she does not own This is equivalent to a negative holding of the share.

**Short the basis**

The purchase of a futures contract as a hedge against a commitment to sell the underlying asset.

**Size effect**

This exists when the return of small firms exceed the risk adjusted returns predicted by the CAPM.

**SPAN**

Standard Portfolio Analysis of Risk. This is a system for calculating initial margins on portfolios of options and futures developed by the CME, and used by them since 16 December 1988, and by LIFFE from 2 April 1991.

**Specialist**

A floor trader charged with the making of a fair and orderly market in particular shares or options.

**Speculation**

Trading on anticipated price changes, where the trader does not hold another position which will offset any such price movements.

**Spot market**

The market in which the asset underlying the futures contract is traded e.g. the stock market.

**Spot price**

A derivation of 'on the spot' usually referring to the cash market price of a financial instrument available for immediate delivery.

**Spread**

The simultaneous purchase of one futures contract and sale of another, in the expectation that the price relationship between the two will change so that the subsequent offsetting sale and purchase will yield a net profit.

**Spread basis**

The difference in the prices of the near and far contracts in a spread.

**Spread margin**

A reduced margin payment for the holder of a spread position.

**Spread ratio**

The number of futures contracts bought, divided by the number of futures contracts sold.

**Stack hedge**

A large position in an existing futures contract is partly rolled over into a later contract month, possibly several times. This procedure may be used to hedge a series of payments or receipts.

**Stale prices**

A price is stale if it refers to the price of a trade that took place some time ago. See infrequent trading.

**Stop order**

A market order to buy when the market price has touched a specified level above the current price, or a market order to sell when the market price has touched a specified level below the current price. Also known as a stop-loss order. Opposite of a market-if-touched order.

**Straddle**

For futures contracts, this is a synonym for a spread.

**Strengthening of the basis**

This occurs when the futures price declines relative to the spot price.

**Strike price**

The stated price per share for which the underlying security may be purchased in the case of a call, or sold in the case of a put, by the option holder upon exercise of the option contract.

**Strip hedge**

A trader takes the same position (long or short) in a future for a series of delivery dates. This may be used to hedge a series of payments or receipts.

**Synthetic futures**

A combination of a long call option and a short put option, or debt and the underlying asset, that replicates the behavior of a long futures contract.

**Systematic risk**

Risk inherent in the market as a whole, which cannot be diversified away. It is measured for each firm by a 'beta' value. Also known as market risk.

**T**

**Tail risk**

The risk created by marking to the market.

**Tailing factor**

The correction factor by which the hedge ratio is multiplied to allow for tail risk.

**Tailing the hedge**

Correcting the size of hedge to allow for the risks of marking to the market.

**Tax timing option**

Capital gain (losses) on shares are taxable when realised. The tax timing option refers to the fact that the owner can choose when to liquidate his or her position in the shares, and hence when the tax liability (or loss) occurs.

**Technical analysis**

The prediction of prices by examining past prices, volume and open interest .

**Term structure of futures prices**

The relationship between futures prices on the same underlying asset, but with a different time to maturity.

**Thin market**

A market with few trades.

**TIMS**

Theoretical Intermarket Margining System. This another system for calculating performance bond (initial margin) requirements for options. It is developed by the Options Clearing Corporation (OCC).

**Tick size**

Minimum permitted movement in the quotation. Measured in index points.

**Time value**

The portion of the option premium that is attributable to the amount of time remaining until the expiration of the option contract. Time value is whatever value the option has in addition to its intrinsic value. This is often referred to as premium.

**Tracking error**

The deviations between a portfolio's performance and that of the portfolio whose performance it is desired to mimic.

**Trading lag**

The time delay between when an order is initiated and executed.

**Trading limit**

The maximum number of contracts that a person can trade in a single day.

**Triple witching hour**

That time every 3 months when four different contracts reach maturity – stock index futures contracts, stock index options on index futures and some options on index futures and some options on individual stocks.

## U

**Uncovered call writing**

A short call option position in which the writer does not own an equivalent position in the underlying security represented by his option contracts.

**Uncovered put writing**

A short put option position in which the writer does not have a corresponding short position in the underlying security or has not deposited, in a cash account, cash or cash equivalents equal to the exercise value of the put.

**Underlying assets**

The security, stock, commodity or index on which a futures contract is based.

**Underpriced**

The actual futures price is less than the no-arbitrage futures price.

**Unsystematic risk**

Risk due to event which affect individual companies, not the market as whole. It can be removed by holding a well-diversified portfolio.

**Uptick**

An increase of one tick in the price of a security.

**V****VaR**

Value at Risk. A risk management methodology, which attempts to measure the maximum loss possible on a particular position, with a specified level of certainty or confidence.

**Value basis**

The actual futures price less the no-arbitrage futures price.

**Value trader**

A trader who buys when assets look underpriced, and sells when assets look overpriced. Such a trader tends to buy when there is a large drop in prices, and sell when there is a large rise, and so tends to stabilise prices.

**Variation margin**

The gain or losses on open contracts, which are calculated by reference to the settlement price at the end of each trading day and are credited or debited by the clearing house to the clearing member's margin accounts and by those members to or from the appropriate customers margin accounts.

**Volatility**

A market is volatile when its prices fluctuate a lot. Academics often choose to measure the volatility of a variable by its variance.

**Volume**

The number of transactions in a futures contract during a specified period of time.

**W****Writer**

The seller of an option contract.

**Z****Zero-sum game**

This is when the gains (losses) of the long positions are exactly equal to the losses (gains) of the short positions. This is true for the market as a whole for all futures products.