INSURANCE

Substitution of a small but certain loss (insurance premium) for the possibility of a large uncertain loss.
COMMODITY OPTIONS
MARKET

Market in which producers may purchase the "opportunity" but not the "obligation" to sell or buy a commodity at a certain price.
TWO MARKETS

- "INSURING" SELLING PRICE

- "INSURING" BUYING PRICE
Want right to sell corn for $3.00/bu.

Purchase right in options market by paying premium

If price when ready to sell is above $3.00
- sell for higher price

If price is below $3.00
- "collect on policy"
CALL OPTION

A contract that gives the holder the right to buy at a specified price

“To call from them”
PUT OPTION

A contract that gives the holder the right to sell at a specified price

"To put it on them"
OPTION BUYER
(HOLDER)

THE PERSON WHO OBTAINS THE
RIGHTS CONVEYED BY THE OPTION
OPTION SELLER
(GRANTOR OR WRITER)

THE PERSON WHO SELLS THE
OPTION AND GRANTS THE RIGHTS
CONTAINED IN IT
EXERCISE

OR

STRIKE PRICE

THE SPECIFIED PRICE AT WHICH THE OPTION PURCHASER MAY BUY OR SELL THE COMMODITY
THE UNDERLYING COMMODITY IS A FUTURES CONTRACT, NOT THE PHYSICAL COMMODITY
EXPIRATION DATE

THE DATE UPON WHICH THE RIGHTS OF THE OPTION PURCHASER EXPIRE
OPTION PREMIUM

THE MARKET VALUE OF THE OPTION.

IN EFFECT, THE PRICE OF THE "INSURANCE"
FACTORS AFFECTING PREMIUMS


- LENGTH OF TIME TO EXPIRATION
INTRINSIC VALUE

"POSITIVE" DIFFERENCE BETWEEN STRIKE PRICE AND UNDERLYING COMMODITY PRICE

FOR A PUT – STRIKE PRICE EXCEEDS FUTURES PRICE

FOR A CALL – STRIKE PRICE BELOW FUTURES PRICE
OPTIONS THAT ARE SAID TO BE:

"IN-THE-MONEY"
HAVE INTRINSIC VALUE

"OUT-OF-THE-MONEY"
HAVE NO INTRINSIC VALUE
TIME VALUE

PORTION OF OPTION PREMIUM RESULTING FROM LENGTH OF TIME TO EXPIRATION

USUALLY TIME VALUE DECREASES WITH LENGTH OF TIME UNTIL EXPIRATION
OFFSET AN OPTION

TO SELL AN EXISTING OPTION CONTRACT IN ORDER TO LIQUIDATE THE OPTION POSITION
MONEY FLOWS

Holding a soybean $7.00 put purchased for a $0.15 premium

OFFSET

Current futures price is $6.50
Sell option at a $0.60 premium

RESULT

Offset premium received $0.60
− Original premium paid $0.15
Net returns $0.45
EXERCISE AN OPTION

TO CONVERT AN OPTION CONTRACT TO
A POSITION IN THE FUTURES MARKET
MONEY FLOWS

Holding a soybean $7.00 put purchased for a $0.15 premium

EXERCISE

Current futures price is $6.50

Receive a short (sell) futures market position at $7.00

Buy futures at $6.50

RESULT

Futures gain $0.50

- Original premium paid $0.15

Net Returns $0.35