

Financial Glossary

A

Acquisition

One company taking control of another by purchasing a majority or all of the target company's outstanding shares. An "unfriendly" or "hostile" acquisition attempt is usually characterized by an offer far in excess of the market value of the shares, which is meant to induce current stockholders to sell. The target company's management may retaliate by soliciting competing offers from other companies in hopes that a bidding war will frighten off the attacker.

Adverse Selection

When smart or wired orders trade with a market maker, trader or specialists in larger proportion to general order flow. This generally occurs in low volume instruments where the market maker has outstanding bids and offers that are taken only when they are off the market because of non-public information.

Agency Cross

A trade in which a single broker acts as the agent for both the buyer and seller. This can occur when a member firm simultaneously receives a buy and a sell order from two different customers but for the same number of shares in the same stock. When these orders reach the floor broker, he can easily cross them and complete the transaction, but only after going to the designated trading post for that stock and announcing the bid in case another broker is prepared to offer a better price.

Agency Order

An order to buy or sell that does not originate from the actual customer for whose account it is executed and who continues to bear all the risk.

American Depository Receipt (ADR)

A receipt that is issued by a U.S. Depository Bank which represents shares of a foreign corporation held by the bank. Because ADRs are quoted in U.S. dollars and trade just like any other stock, they make it simple for investors to diversify their holdings internationally.

American Option

An option that may be exercised at any time between its purchase and its expiration date.

American Stock Exchange (Amex)

An open auction market similar to the NYSE where buyers and sellers compete in a centralized marketplace. The Amex typically lists small to medium cap stocks of younger or smaller companies. Until 1921 it was known as the New York Cumulative Exchange.

Annual Report

A publication that is issued yearly by all publicly held corporations and freely available to all shareholders. It reveals the company's assets, liabilities, revenues, expenses, and earnings for the past year, along with other financial data. This is often accompanied by a glossy presentation of the company's achievements and philosophy, but it is the accounting information that is required by law to allow investors to gauge the financial health of the company.

Arbitrage

The act of buying or selling one product and parsing out its inherent risks, then trading similar, but opposite risks for better value.

There are two “categories” of arbitrage. Weak arbitrage and strong arbitrage. A strong arbitrage means that the relationship between what you bought and sold is defined and will be forced by the market place to an established price. A futures price related to the underlying cash product is a strong arbitrage. A weak arbitrage means that the relationship is more theoretical. For example, you could buy one series of calls and sell calls one strike away, knowing that many factors affect the prices of both.

Assets

Property and items of value owned by a person or business. The primary classifications of assets are:

current assets: cash and other liquid instruments, including accounts receivable, that can be converted to cash within one year at maximum;

long term assets: plants, equipment, real estate and other capital assets, net of depreciation;

prepaid and deferred assets: expenditures for future costs or expenses, such as insurance, interest or rent, that are set up as assets to be amortized over an applicable period;

intangible assets: assets with a determined value, but which may not be scalable, such as goodwill, patents, copyrights, and brand name recognition.

Assignment (options)

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.

Associated Person

Associated Person (AP): An individual who solicits orders, customers, or customer funds (or who supervises persons performing such duties) on behalf of a Futures Commission Merchant, an Introducing Broker, a Commodity Trading Adviser, or a Commodity Pool Operator.

At the money (ATM) (options)

At the money options. Options whose strike price is close to the price of the underlying and have a delta of about 40 to 60. Because of implied interest rates, options in the far term months will be at the money at a higher price.

B

Balance Sheet

A condensed financial statement showing the nature and amount of a company's assets, liabilities and capital on a given date. In dollar amounts the balance sheet shows what the company owns, what it owes, and the ownership interest in the company of its stockholders.

Backspread (options)

This means a net long premium is greater than the short premium position in a way that results in positive gamma (shorter deltas on the way down, and longer deltas on the way up) and decay expense. Since the front months deliver more gamma and decay per option premium dollar, they will tend to deliver more 'backspread' per dollar.

Bar Chart

A chart that graphs the high, low, and settlement prices for a specific trading session over a given period of time. A vertical line runs from the high price to the low price and a horizontal hash indicates the closing price.

Basis (futures)

The difference in price between two related derivatives or commodities. For example, the current cash price and the futures price of the same commodity.

Bear Market

A term to describe a market of declining prices.

Beta

Coefficient measuring a stock's relative VOLATILITY. The beta is a covariance of the stock in relation to the rest of the stock market. The Standard & Poor's 500 Stock Index has a beta coefficient of 1. Any stock with a higher beta is more volatile than the market, and any with a lower beta can be expected to rise and fall more slowly than the market. A conservative investor whose main concern is preservation of capital should focus on stocks with low betas, whereas one willing to take high risks in an effort to earn high rewards should look for high-beta stocks.

Bid

An expression indicating a desire to buy a commodity at a given price; opposite of offer.

Bid/Ask

Collectively called the "quote," the bid refers to the highest price a buyer is willing to pay for a stock, while the ask is the lowest price a seller will accept.

Bloom (coined term)

A situation in which a stock or futures price goes up rapidly with a small demand, finds ample supply and the demand evaporates. By the time you realize what is going on, the stock or future is trading lower. To trade a bloom, you need to anticipate what is going to happen and get your offer in QUICKLY. Picture it as a mushroom cloud that goes up, then dissipates. This can happen when a buyer comes to the market when there is not much liquidity, or a news event is traded on in panic before the implications are understood (this is the opposite of a plop).

Blow Out or Blow Up

When traders losses so much capital they can no longer stay in business. Often they will lose more than they have, creating a deficit with their clearing firm.

Blue Chip

A company known nationally for the quality of its products or services, its reliability, and its ability to operate profitably in good and bad economic times.

Board of Trade Clearing Corporation

An independent corporation that settles all trades made at the Chicago Board of Trade. It acts as a guarantor for all trades cleared by it, reconciles all clearing member firm accounts each day to ensure that all gains have been credited and all losses have been collected, and sets and adjusts clearing member firm margins for changing market conditions. Also referred to as the clearing corporation.

Bonds

Bonds are promissory notes or IOUs issued by a corporation or government to its lenders. They are usually issued in multiples of \$1,000 or \$5,000, although \$100 and \$500 denominations are available.

A bond is evidence of a debt on which the issuing company usually promises to pay the bondholder a specified amount of interest at intervals over a specified length of time, and to repay the original loan on the expiration date. A bond represents debt, therefore its holder is a creditor of the corporation and not a part owner, as the stockholder is.

Book Value

An accounting term. The book value of a stock is determined by adding up all of a company's assets and then deducting all of its debt and liabilities, including the liquidation price of any preferred issues. This sum is then divided by the number of common shares outstanding and the result is book value per common share.

Book value of a company's assets or of a security may have little relationship to the market value.

Broker

A company or individual that executes futures and options orders on behalf of financial and commercial institutions and/or the general public. He charges a commission for this service

Bull Spread

In most commodities and financial instruments, the term refers to buying the nearby month, and selling the deferred month to profit from the change in the price relationship.

Butterfly (options)

This option combination has three parts in a series (i.e. all calls or all puts). The outside strikes (wings) are an equal distance from the body (inside strike). This spread consists of one of each wing and two of the body in the opposite position. For example, long one 55 call, short two 50 calls and long one 45 call.

Buy-write (options)

When you buy the stock and sell (write) a call (usually out of the money) against it. The theory is that if you own the stock and it does not move, you get the value of the call. If the stock goes up by expiration, you sell it at the strike price of the call, which you are happy with, plus you get the premium. This works well in slowly trending up markets. Buy writing is similar to selling a put with its downside risk.

C

Calendar Spread

Buying and selling the same strike in different expiration months.

Call Option

An option that gives the buyer the right, but not the obligation, to purchase (go "long") the underlying futures or equity at the strike price on or before the expiration date.

Capital Stock

All shares representing ownership of a business, including common and preferred.

Capitalization

Total amount of various securities issued by a corporation. Capitalization may include bonds, debentures, preferred and common stock, and surplus.

Capped Option

An option with an established profit cap or cap price. 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.

Carrying Charge

For physical commodities such as grains and metals, the cost of storage space, insurance, and finance charges incurred by holding a physical commodity. In interest rate futures markets, it refers to the differential between the yield on a cash instrument and the cost of funds necessary to buy the instrument. Also referred to as cost of carry or carry.

Cash Flow

Reported net income of a corporation plus amounts charged for depreciation, depletion, amortization, and extraordinary charges to reserves which are bookkeeping deductions and not paid out in actual dollars and cents.

Cash Market (futures)

This refers to the physical commodity defined in the futures contract that satisfies delivery. When a trader goes to the “cash market” he is actually purchasing the physical commodity.

Cash Market (stocks)

This is stock bought or sold for same day settlement. Normally, the stock seller is given 3 days to deliver the stock, but in a cash settlement, the stock is delivered the same day and premium prices are usually paid for this arrangement. It is usually forced on the stock short because of a stock squeeze, takeover, or prior to a dividend because there is a different treatment of income from dividends than capital gains.

Cash Settlement

Transactions generally involving index-based futures contracts that are settled in cash based on the actual value of the index on the last trading day, in contrast to those that specify the delivery of a commodity or financial instrument.

Cash Value of account

This is the value of your positions determined by the market price. To find the cash value, multiply all your option and stock positions by their closing price. The total is the cash value of your account.

CBOE

The Chicago Board of Options Exchange was spun out of the Chicago Board of Trade. It has been the largest stock options exchange in the world. CBOE pioneered options on stock indexes with the OEX contract.

CBOT

The Chicago Board of Trade. The oldest futures exchange in the United States, established in 1848.

CFTC

The Commodity Futures Trading Commission created by Congress in 1974 to regulate exchange trading in futures.

Cheapest to Deliver

A method to determine which particular cash debt instrument or grade of commodity is most profitable to deliver against a futures contract.

Circuit Breakers

In response to the market breaks in October 1987 and October 1989, the New York Stock Exchange instituted several circuit breakers to reduce market volatility and promote investor confidence. However, these were created by the same thinking that created the uptick rule for short stock sales. By introducing more unknowns into the system and reducing the opportunity to trade, the circuit breakers may have the opposite effect as intended.

Class of Options

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

Clearing Margin

Financial safeguards to ensure that clearing members (usually companies or corporations) perform on their customers' open futures and options contracts. Clearing margins are distinct from customer margins that individual buyers and sellers of futures and options contracts are required to deposit with brokers

Clearing Member

A member of an exchange clearinghouse. Memberships in clearing organizations are usually held by companies. Clearing members are responsible for the financial commitments of customers that clear through their firm.

Close/close

This refers to a spread or combo that when executed will close two sides of an open position. In options, it is often done at value to reduce strike risk. In futures, it would be closing out the position on the underlying and the futures at the same time.

Closing Range

The range of prices at which buy and sell transactions took place during the market close.

Closing Transaction

A transaction in which the buyer's or seller's intention is to eliminate a position.

CME

The Chicago Mercantile Exchange. A futures exchange that was established in 1898. It introduced the S&P Futures Exchange in 1982

Combination
trade (combo)
(options)

A trade that involves more than one option and perhaps the stock. Usually refers to a trade that is not already named.

COMEX

The Commodity Exchange of New York.

Commission Fee

A fee charged by a broker for executing a transaction. Also referred to as a brokerage fee.

Commodity

An article of commerce or a product that can be used for commerce. In a narrow sense, products traded on an authorized commodity exchange. Types of commodities include agricultural products, metals, petroleum, foreign currencies, and financial instruments and indexes, to name a few.

Commodity Pool

An enterprise in which funds contributed by a number of persons are combined for the purpose of trading futures contracts or commodity options.

Commodity Pool
Operator (CPO)

An individual or organization that operates or solicits funds for a commodity pool.

Commodity
Trading Adviser
(CTA)

A person who, for compensation or profit, directly or indirectly advises others as to the value or the advisability of buying or selling futures contracts or commodity options. Advising indirectly includes

exercising trading authority over a customer's account as well as providing recommendations through written publications or other media.

Common Stock

Securities that represent an ownership interest in a corporation. If the company has also issued preferred stock, both common and preferred have ownership rights. Common stockholders assume the greater risk, but generally exercise the greater control and may gain the greater award in the form of dividends and capital appreciation. The terms common stock and capital stock are often used interchangeably when the company has no preferred stock.

Convergence

A term referring to cash and futures prices tending to come together (i.e., the basis approaches zero) as the futures contract nears expiration.

Conversion (options)

Selling calls, buying puts in the same strike and buying an equal amount of stock in one transaction. This trade has no deltas, gamma or vega. It does contain a small amount of interest rate risk depending on how long to expiration. This trade will allow you to obtain long stock so you can sell on a downtick. You will be lending dollars in this transaction so you will receive a premium above even for this trade (see reversal for the opposite side of this transaction).

When you 'do' a conversion, you sell the interest rate expense and thus you are 'at' a price when it is quoted.

When you 'do' a reversal (the other side of a conversion), you are bid and you buy the interest rate income.

CORCO (coined)

Choosing Opportunity and Risk Continually. With derivatives, an investor or trader is able to create a portfolio that accurately represents the exact opportunity that the trader wants to create. An options trader, for example, can buy a call and sell stock as a way of owning just the risk inherent in the volatility component of options, and not the delta (directional) risk. Every Corco has both a risk and reward attached to it.

Covered Option

An option whose writer (seller) maintains the appropriate opposing position in the underlying security. Usually refers to the seller of a call who purchases 100 shares of the underlying stock for each option sold.

Crush Spread

The purchase of soybean futures and the simultaneous sale of soybean oil and meal futures. See Reverse Crush.

Customer Margin

Within the futures industry, financial guarantees required of both buyers and sellers of futures contracts and sellers of options contracts to ensure fulfillment of contract obligations. FCMs are responsible for overseeing customer margin accounts. Margins are determined on the basis of market risk and contract value. Also referred to as performance-bond margin.

D

Daily Trading Limit

The maximum price range set by the exchange each day for a contract. After the price reaches the limit, trading stops. Limits rules are different for each contract. The method behind the madness is to try to allow markets to settle down without such extreme movements and allow clearing firms to collect maintenance margins in an orderly fashion. Market prices can be obtained from the delivery month (first or front month) if it is exempt, or often the cash market is quoted so the players know where the market is trading when the futures are closed.

Day Order

An order to buy or sell which, if not executed, expires at the end of the trading day on which it was entered.

Day Traders

Speculators who take positions in futures or options contracts and liquidate them prior to the close of the same trading day. Usually day traders trade off floor.

Deep Options (options)

These are options that are deep in the money. Calls whose strike is below the current stock price or puts whose strike is above the current stock price. The options are considered "deep" once their deltas become 85 or above

Deliverable Grades

The standard grades of commodities or instruments listed in the rules of the exchanges that must be met when delivering cash commodities against futures

contracts. Grades are often accompanied by a schedule of discounts and premiums allowable for delivery of commodities of lesser or greater quality than the standard called for by the exchange. Also referred to as contract grades.

Delivery

The transfer of the cash commodity from the seller of a futures contract to the buyer of a futures contract. Each futures exchange has specific procedures for delivery of a cash commodity. Some futures contracts, such as stock index contracts, are cash settled.

Delivery Day

The third day in the delivery process at the Chicago Board of Trade, when the buyer's clearing firm presents the delivery notice with a certified check for the amount due at the office of the seller's clearing firm.

Delivery Month

A specific month in which delivery may take place under the terms of a futures contract. Also referred to as contract month.

Delivery Points

The locations and facilities designated by a futures exchange where stocks of a commodity may be delivered in fulfillment of a futures contract, under procedures established by the exchange.

Delta

A measure of how much an option premium changes, given a unit change in the underlying futures price. Delta often is interpreted as the probability that the option will be in-the-money by expiration. More generally it refers to the differences between one position and another.

Derivatives

These are financial products that relate to a commodity or stock or other tangible financial instrument. Futures, options, swaps, collars, and indexes are examples

Dividend

The payment designated by the Board of Directors to be distributed pro rata among the shares out-standing. For preferred shares, the dividend is usually a fixed amount. For common shares, the dividend varies with the fortunes of the company and the amount of cash on hand, and may be omitted if business is poor or if the directors determine to withhold earnings to invest in plants and equipment. Sometimes a company will pay a dividend out of past earnings even if it is not currently operating at a profit.

The Dow Jones Industrial Average (DJIA)

The Dow Jones Industrial Average (DJIA) is an index used to measure the performance of the U.S. financial markets. Introduced on May 26, 1896 by Charles H. Dow, it is the oldest stock price measure in continuous use. Over the past century "the Dow" has become the most widely recognized stock market indication in the U.S. and probably in the entire world. The 30 stocks included in today's Dow are listed on the New York Stock Exchange, except for Microsoft and Intel, and are all large blue-chip companies that reflect the health of the U.S. economy. All but a handful of these have major business operations throughout the rest of the world, thus providing some insight into the economic well-being of the global economy.

Downtick/Uptick

This is a transaction that is priced lower than the previous transaction. If the previous transaction or

series of transactions is the same price as the last, you keep going back in time to a transaction that is different to determine if the current trade is an uptick or downtick.

For example: If a stock's last trade was priced at \$50 and you want to sell short at \$50, your sale will not be executed if that stock has traded in the sequence \$50, \$50, \$50, \$50 1/8, \$50, \$50, \$50. All short sales must be entered as such and a short sale will not be executed at \$50 because the trading price before \$50 was \$50 1/8. You could short the stock at \$50 if the previously traded price before \$50 was below \$50. If a stock trades \$50, \$50, \$50, \$49 7/8, \$50, \$50, \$50 you can short it at \$50 since the previous trade before \$50 was \$49 7/8.

In stocks, it is illegal to sell short on a downtick. (this means you must own the stock before you can sell it on a downtick) The purpose of this rule is an attempt to legislate stock direction. It was written to prevent well-capitalized raiders from forcing a stock lower by shorting it and profiting from its demise. Stupid, but it has to be dealt with. If you need long stock to hit down ticks, you can go to the options markets, buy a conversion which will give you long stock in your account. Single stock futures don't require a downtick, but the hedger will price this opportunity into the future/equity spread.

E

Edge

The difference between the theoretical value and the market pricing. The greater the difference, the greater the edge and the more statistically profitable the trade. This can refer to option valuations or cash to futures spreads.

Equilibrium Price

The market price at which the quantity supplied of a commodity equals the quantity demanded.

Equity

Ownership in a company. Whereas bonds represent debt, stocks represent equity.

Exchange For Physicals (EFP)

A transaction generally used by two hedgers who want to exchange futures for cash positions. Also referred to as against actuals or versus cash.

Exercise

The action taken by the holder of a call option if he wishes to purchase the underlying futures contract or by the holder of a put option if he wishes to sell the underlying futures contract.

Expiration Date

Options on futures generally expire on a specific date during the month preceding the futures contract delivery month. For example, an option on a March futures contract expires in February but is referred to as a March option because its exercise would result in a March futures contract position.

F

FIA

Futures Industry Association

Fill-or-Kill

A customer order that is a price limit order that must be filled immediately or canceled.

Financial Futures

Futures contracts based on financial instruments such as U.S. Treasury bonds, CDs and other interest-sensitive issues, currencies and stock market indicators.

Floor Broker

An individual who executes orders for the purchase or sale of any commodity futures or options contract on any contract market for any other person.

Floor Trader

An individual who executes trades for the purchase or sale of any commodity futures or options contract on any contract market for such individual's own account.

Forex Market

An over-the-counter market where buyers and sellers conduct foreign exchange business by telephone and proprietary screens. Also referred to as foreign exchange market.

Frontspread (options)

This means your short premium is greater than your long premium position. This results in negative gamma (longer deltas on the way down, and shorter deltas on the way up) and positive decay income. Since the front months deliver more gamma and decay per option premium dollar, they will tend to deliver more 'frontspread' per dollar.

Full Carrying Charge Market

A futures market where the price difference between delivery months reflects the total costs of interest, insurance, and storage.

Fundamental Analysis

A method of anticipating future price movement using supply and demand information, corporate and market analysis

Fungible

Standardized products that meet a criteria for equivalent exchange and delivery.

Futures Commission Merchant (FCM)

An individual or organization that solicits or accepts orders to buy or sell futures contracts or options on futures and accepts money or other assets from customers to support such orders. Also referred to as commission house or wire house.

Futures Contract

A legally binding agreement, made on the trading floor of a futures exchange, to buy or sell a commodity or financial instrument sometime in the future. Futures contracts are standardized according to the quality, quantity, and delivery time and location for each commodity. The only variable is price, which is discovered on an exchange trading floor.

Futures Exchange

A central marketplace with established rules and regulations where buyers and sellers meet to trade futures and options on futures contracts.

G

Gamma

A measurement of how fast delta changes, given a unit change in the underlying futures price.

Gamma (options)

The rate of change of deltas given a one point move in the underlying stock. To figure this, look at the delta position one dollar apart and calculate the difference in deltas at those two prices. This equals the gamma value. You can have positive gamma (you get longer when the stock goes up and short when it goes down), or negative gamma, (shorter when the stock goes up and longer when the stock goes down).

Good 'til Cancelled

An order to buy or sell that remains in effect until it is either executed or canceled. Also called an Open Order.

H

Hedging

The practice of offsetting the price risk inherent in any cash market position by taking an equal but opposite position in the futures market. Hedgers use the futures markets to protect their businesses from adverse price changes. See Selling (Short) Hedge and Purchasing (Long) Hedge.

I

Implied Volatility (options)

This is the theoretical volatility applied to an option formula to arrive at the option price. It is a number that ranges from 25 to 75 in most equity options.

Initial Public Offering

An issue of new stock by a once private company to transform itself into a publicly held one. IPOs are usually done to raise cash for growing young companies that need larger sources of capital than the private sector can provide. The new shares are sold to one or more investment banks, which then sell them to the public.

In-the-money (ITM) (options)

A call whose strike price is below the current price of the stock or a put whose strike price is above the current price of the stock. This option, if exercised, has intrinsic value because the exercise price of the option is better than the current market price.

Intrinsic Value (options)

The value of an option that equals the amount that it is “in the money.”

Introducing Broker (IB)

A person or organization that solicits or accepts orders to buy or sell futures contracts or commodity options but does not accept money or other assets from customers to support such orders.

K

KCBOT

Kansas City Board of Trade. Futures exchange established in 1876, primarily as a grain exchange. It innovated futures on stock indexes with the Value Line index in the early 1980s.

L

Lean

This is limiting a loss by 'leaning' on a limit order. If your market moves against your position, you can take out the limit order (the lean). Every limit order presents an implied option.

Leaps (options)

These are long term options that are listed only for the month of January with expiration dates up to three years in the future.

Legged Out

Legged out means that you have intended to put on a balanced position (such as buy calls and sell stock, or buy September futures and sell December futures). However, you have completed one side of this transaction and not the other.

Leverage

Using fewer dollars to control a position than it is worth. This means that as you use fewer and fewer dollars for the same position, your leverage increases. The potential gain or loss for that same dollar goes up proportionately.

Limit Orders

Orders with a price that limits their execution to that price or better (a maximum price for a buy order and a minimum price for a sell order). If not immediately executable, they sit in the book or in a broker's deck until the market price allows execution.

Liquid

A characteristic of a security or commodity market with enough active bids and offers and trading volume to allow large transactions without a substantial change in price. Institutional investors are inclined to seek out liquid investments so that their trading activity will not influence the market price.

Listed Stock

The stock of a company that is traded on a securities exchange. The various stock exchanges have different standards for listing. Some of the guides used by the New York Stock Exchange for an original listing are national interest in the company and a minimum of 1.1 million shares publicly held among not less than 2,000 round-lot stockholders. The publicly held common shares should have a minimum aggregate market value of \$18 million. The company should have net income in the latest year of over \$2.5 million before federal income tax and \$2 million in each of the preceding two years.

Long

Signifies ownership of a security or futures. A long position benefits from a price rise.

M

Maintenance Margin (futures)

A set minimum margin (per outstanding futures contract) that a customer must maintain in his margin account.

Margin (stocks)

The amount paid by the customer when using a broker's credit to buy or sell a security. Under Federal Reserve regulations, the initial margin required since 1934 has ranged from 40% of the purchase price up to 100%. Since 1974 the current rate of 50% has been in effect.

Margin Call

A demand upon a customer to put up money or securities with the broker. The call is made when a purchase is made; also if a customer's equity in a margin account declines below a minimum standard set by the exchange or by the firm.

Market Maker

A broker/dealer who is registered to trade in a given security on the NASDAQ or the floor of a securities options exchange. Market makers on futures exchanges tend to be called 'locals.'

Market on Close (MOC)

A market order which is to be executed in its entirety at the closing price, on the Exchange, of the stock named in the order; and if not so executed, is to be treated as cancelled. The term "at the close order" shall also include a limit order that is entered for execution at the closing price, on the Exchange, of the stock named in the order pursuant to such procedures as the Exchange may from time to time establish.

Market Order

An order to buy or sell at the best price currently available when sending an order to the Trading Floor. With the advent of electronic trading, market orders don't make sense because everyone knows where the market is at any given time.

Marking-to-Market

To debit or credit on a daily basis a margin account based on the close of that day's trading session. In this way, buyers and sellers are protected against the possibility of contract default.

Master of the Universe

A confident and winning trader who is so taken with his god like powers, he (and I mean he...rarely female) believes he is so wired to the market that he doesn't need to account for certain "unlikely" risks. This attitude carries into his or her character and personality away from the trading desk or floor.

Moving-Average Charts

A statistical price analysis method of recognizing different price trends. A moving average is calculated by adding the prices for a predetermined number of days and then dividing by the number of days.

Musical Chair Risk (options)

When a stock and its options go quiet suddenly and you are long option premium with the premium collapsing and no one to sell the premium to. You are stuck with your long option position as the losses eat into your equity everyday. There is no way out. When the music stops — be sure you have a chair.

N

NASD

The National Association of Securities Dealers is an industry association of broker/dealers in the over-the-counter securities business. The NASD is a self-regulatory body and administers the NASDAQ stock market.

NASDAQ

An automatic information network that provides brokers and dealers with price quotations on securities traded over-the-counter.

National Futures Association (NFA)

An industry-wide, industry-supported, self-regulatory organization for futures and options markets. The primary responsibilities of the NFA are to enforce ethical standards and customer protection rules, screen futures professionals for membership, audit and monitor professionals for financial and general compliance rules, and provide for arbitration of futures-related disputes.

Nearby Delivery Month (futures)

The futures contract month closest to expiration. Also referred to as spot month.

NewsNoise (coined)

This is the purposefully created noise about the market that is designed to excite, worry or stimulate the listener. Eventually, this NewsNoise can create an addictive state in the listener.

Noise

In physics, noise is defined as a disturbance, especially a random and persistent disturbance that obscures or reduces the clarity of a signal. It is also used in computer science to describe irrelevant or meaningless data. In trading, most information is noise. It is impossible to distinguish the irrelevant information from the truly significant information. The more information a trader has, the lower the signal (relevant information) to noise ratio.

Normal distribution

A normal distribution of stock prices means there is a decreasing likelihood in the future of a stock trading at a price that is away from the current price. The further the future price is away from the current price, the less likely that it will trade there. This decreasing likelihood is a smooth curve in the shape of a bell, with the current price being the bell loop at the top and the away prices being the lip on the bottom.

O

OCC

Options Clearing Corporation. Owned jointly by the participating options exchanges. OCC clears and guarantees trades for all the stock option marketplaces. An option bought on one exchange can be sold on another liquidating the position because of the common clearing arrangement.

Odd Lots

Stock trade of less than 100 shares.

Open Interest

In options and futures trading, the number of outstanding option contracts at any given time which have not been exercised and have not yet reached expiration.

Option

A contract that conveys the right, but not the obligation, to buy or sell a particular item at a certain price for a limited time. Only the seller of the option is obligated to perform.

Option Buyer

The purchaser of either a call or put option. Option buyers receive the right, but not the obligation, to assume a futures position. Also referred to as the holder.

Option Premium

The price of an option. The sum of money that the option buyer pays and the option seller receives for the rights granted by the option.

Option Seller

The person who sells an option in return for a premium and is obligated to perform when the holder exercises his right under the option contract. Also referred to as the writer.

Option Spread

The simultaneous purchase and sale of one or more options contracts, futures, and/or cash positions.

Order Types

Market Order:

This order states: Buy 1000 XYZ market. The price is not included because the sender is not sure what the price will be when the market order hits the floor. The

broker is responsible to execute the order as soon as possible at the best available price. With electronic trading, the market order does not make sense in its original context and may simply become a quick order entry vehicle.

Limit Order:

This order States: Buy 1000 XYZ pay \$40.50. This instructs the broker or software to buy XYZ for \$40.50 or better (less) if able. But, at no time can it be filled at a worse (higher) price. Every order has a free option imbedded in it.

Stop Order:

A buy order that is priced above the current price or a sell order priced below the current price. If XYZ is trading for \$50.00, the buy order would read: Buy Stop 1000 XYZ pay \$51.00. A sell order would be the opposite. A sale BELOW the current price. Why would someone want to pay MORE than the current price? It can be used to limit losses or enter a trending market. A Stop order becomes a market order unless it is designated a stop limit order in which case it can only be executed at that limit. At stop limit order risks not being executed.

MIT (Market if touched) Order:

Turns a limit order bid below the market or an offer above the market into a market order if a given price is traded. This avoids the problem of a limit order going unfilled if the price is just "touched" and not traded through.

GTC (Good 'til Cancelled) Order:

Like it says. Leaves the limit in until the customer cancels. Exchanges have rules about these and brokers may have to re-enter depending on the rules. It is always a surprise to get a fill on a "GTC" that has been forgotten.

OCO (One cancels the other) Order:

This can be used in options or futures where you have orders in more than one series or month, but don't want to be filled in both. This order has to be manually managed by the broker.

MOC (Market on Close) Order:

Trade on the close only.

Cancel and Replace Order:

As it says. Cancel one order and replace it with another of a different price, size or series.

Original Margin

The amount a futures market participant must deposit into his margin account at the time he places an order to buy or sell a futures contract. Also referred to as initial margin.

Out-of-the-Money Option (OTM)

An option with no intrinsic value, i.e., a call whose strike price is above the current futures price or a put whose strike price is below the current futures price.

Over the Counter (OTC)

Stocks that trade via the NASDAQ system. There is no central location and each market maker makes his/her

own markets. You cannot get precedence by placing an order on the bid or offer.

Over-the-Counter Market (OTC)

A market where products such as stocks, foreign currencies, and other cash items are bought and sold by telephone and other means of communication.

P

Pacific Exchange (PCX)

Pacific Stock Exchange. Trades both stocks and options.

Par

The face value of a security. For example, a bond selling at par is worth the same dollar amount it was issued for or at which it will be redeemed at maturity.

Parity

Equality of prices of goods or securities in two different markets.

Philadelphia Stock Exchange (PHLX)

Philadelphia Stock Exchange. Trades both stocks and options on stocks.

Pit

The area on the trading floor where futures and options on futures contracts are bought and sold. Pits are usually raised octagonal platforms with steps

descending on the inside that permit buyers and sellers of contracts to see each other.

Plop (coined term)

This is when small sellers push a stock down and it hits an ample supply. The sellers evaporate and the stock bounces back quickly. You need to anticipate a plop, because by the time it is evident, you won't be able to buy the stock. This can happen when a seller comes to the market when there is not much liquidity, or a news event is traded on in panic before the implications are understood (opposite of a bloom).

Point-and-Figure Charts

Charts that show price changes of a minimum amount regardless of the time period involved.

Position

A market commitment. A buyer of a futures contract is said to have a long position and, conversely, a seller of futures contracts is said to have a short position.

Position Limit

The maximum number of speculative futures contracts one can hold as determined by the Commodity Futures Trading Commission and/or the exchange upon which the contract is traded. Also referred to as trading limit.

Position P&L

Your position P&L is the P&L that would result from changes in value in your position only, including hedges to manage that position. It would not include new options trades.

Position Trader

An approach to trading in which the trader either buys or sells contracts and holds them for an extended period of time.

Potential Profits (options)

The difference in your cash position (all futures, stock and options priced at current prices) and your positions times your theoretical values. If this number is negative (which it will be most of the time) it means that your theoretical values give you greater profits than the cash markets. If the number positive, this means that the cash markets value your options position better than your theoretical values.

Premium (options)

The amount of money an option is worth after deducting any intrinsic value.

Premium (futures)

The price difference between a cash market and its futures or between two different futures months.

Price Discovery

The generation of information about ""future" cash market prices through the futures markets.

Priority (stock)

A stock order that is traded ahead of other orders because of the time it was entered or other considerations (book vs. market maker or customer vs. broker).

Put Option

An option that gives the buyer the right but not the obligation to sell (go "short") the underlying futures

contract at the strike price on or before the expiration date.

R

Resistance

A level above which prices have had difficulty penetrating.

Reversal (option)

This is a combination trade whereby you buy calls and sell puts in one strike, and sell an equal number of shares of stock. This will give you short stock. You are borrowing money and will have to pay a premium over even for this trade. You would do this when you have excess long stock or the trade is better than interest rates.

When you 'do' a reversal, (the other side of a conversion) you are bid and you buy the interest rate income.

When you 'do' a conversion, you sell the interest rate expense and thus you are 'at.'

Rho (options)

The dollar change as the interest rate component of your values change by 1%.

S

Scalper

A trader who trades for small, short-term profits during the course of a trading session, rarely carrying a position overnight.

Scalping

The act of buying and selling the same instrument in volume, adjusting your bids and offers to avoid accumulating a position.

SEC

Securities and Exchange Commission. This is the primary federal agency that regulates all stock and equity markets. The primary mission of the U.S. Securities and Exchange Commission (SEC) is to protect investors and maintain the integrity of the securities markets.

Series (options)

An options strike price consisting of both calls and puts.

Settlement Price

The last price paid for a commodity on any trading day or the last trading day of a derivative. The exchange clearinghouse determines a firm's net gains or losses, margin requirements, and the next day's price limits, based on each futures and options contract settlement price. If there is a closing range of prices, the settlement price is determined by averaging those prices. Also referred to as settle or closing price.

Short

To sell a stock without owning it. Also, a position that sells a stock or derivative without owning the underlying security and benefits from a downward move in price.

Short Selling

When you short a stock you borrow the stock from your broker and sell it in the market hoping to buy it back later at a lower price. Here's how it works:

Assuming you think IBM stock will decline in price, you short 100 shares trading at \$60 a share. You borrow these shares from your broker who then sells them at the going price and deposits the \$6,000 from the sale in your account. Now you owe the broker 100 shares of IBM regardless of the price of the stock. Assume the price of IBM falls to \$50. You buy the 100 shares in the market for \$5,000 and return the shares to your broker. This leaves you with a profit of \$1,000 excluding commissions. If IBM increases, you must buy back the stock at a higher price, say \$70, and return the shares to your broker, but you have lost \$1,000. (See Uptick rule.)

Short Squeeze

When people are short a stock or future and find it difficult to obtain the underlying commodity or security. They are forced to either buy in their short position or pay high prices for the underlying security. In equities, this can be caused by owners of shares calling in the securities they lent out. In futures, this may be because the goods that are qualified for delivery are in short supply relative to the long futures holders who are demanding delivery of the goods.

Skewing (options)

This refers to adjusting the volatility of options on a strike by strike basis to adjust the values of the option prices to reflect market implied volatility realities. Adjusting the implied volatility by strike will change the delta position and the profit and risk curve.

Slippage

The cost of execution in addition to commission. It can be increased by a number of factors. A wide bid/offer spread in illiquid markets can be a significant cost of doing business.

Speculator

A market participant who tries to profit from buying and selling futures and options contracts by anticipating future price movements. Speculators assume market price risk and add liquidity and capital to the futures markets.

Spot (futures)

Usually refers to a cash market price for a physical commodity that is available for immediate delivery.

Spot Month (futures)

See Nearby (Delivery) Month.

Spread

A long and a short position in related markets. Also, the price difference between two related markets.

Spreading

The simultaneous buying and selling of two related markets in the expectation that a profit will be made when the position is offset. Examples include: buying one futures contract and selling another futures contract of the same commodity but different delivery month, buying one option strike and selling another, or buying one index and selling another. Spreading is one form of arbitraging.

Straddle (options)

This is a buy a call and a put, or sell a call and a put of the same strike.

Strangle,inside (options)

This is a buy/buy or sell/sell combo trade where you buy (or sell) both an in the money call, and an in the money put.

Strangle, outside (options)

This is a buy/buy or sell/sell combo trade where you buy (or sell) both an out of the money call, and an out of the money put.

Strike (options)

The fixed stock price assigned to an option. This is the price that is received or paid if the option is exercised. When the stock price is above the strike price of a call option, the option is said to be “in the money.” If the stock price is below the strike price of a put option, the put is said to be “in the money.”

Strike Risk (options)

Te risk of having a large position in one strike when the market settles at or near that price.

Stock

Securities that represent an ownership interest in a corporation. If the company has also issued preferred stock, both common and preferred have ownership rights. Common stockholders assume the greater risk, but generally exercise the greater control and may gain the greater award in the form of dividends and capital appreciation. The terms common stock and capital stock are often used interchangeably when the company has no preferred stock.

Stock Index

An indicator used to measure and report value changes in a selected group of stocks. How a particular stock index tracks the market depends on its composition, the sampling of stocks, the weighting of individual stocks, and the method of averaging used to establish the index.

Stock Market

A market in which shares of stock are bought and sold.

Stock Split

When a company increases the number of shares outstanding by splitting existing shares. A 2-for-1 split means every stockholder gets two new shares for each one they own, and a 3-for-2 split means they get three shares for every two they own. The price of an individual share falls, but stockholders do not lose money because they are being given an equivalent number of new shares.

In a reverse stock split, a company reduces the number of shares outstanding by consolidating existing shares. A 1-for-5 reverse split, for example, means that for every five shares owned, one receives a single new share. The price of the new share is five times higher, but only to reflect the reduced supply. If a company's stock is trading at a very low price, this process makes the company look more attractive to investors.

Stop-Limit Order

A variation of a stop order in which a trade must be executed at the exact price or better. If the order cannot be executed, it is held until the stated price or better is reached again.

Stop Loss

This is a price set by a trader to limit losses. Once the price hits this point, the position is liquidated as soon as possible.

Stop Order

This is an order to buy placed *above* the market or a sell order placed *below* the market that turns into a market order when the stop price of the order is traded. It is generally used to protect a position against extreme losses, but is sometimes used to enter a trending market. These orders can be filled significantly away from the stop price since many times additional stop orders are at similar prices creating additional market pressures, or they are hit when the markets are volatile and thin.

Strike Price (options)

The price at which the futures contract underlying a call or put option can be purchased (if a call) or sold (if a put). Also referred to as the exercise price.

Support

The place on a chart where the buying of futures contracts is sufficient to halt a price decline.

Synthetic (options)

The creation of a synthetic stock position by using options. Specifically, the purchase and sale of the same strike call and put. If you buy the call and sell the put, you create a synthetic long stock position. If you buy the put and sell the call, you create a synthetic short stock position. There are different interest rate carrying charges and dividend implications between the synthetic position and the actual stock ownership or short stock

position, and these differences are reflected in the price of the synthetic.

T

Technical Analysis

Anticipating future price movement using historical prices, trading volume, open interest, and other trading data to study price patterns.

Tick

The smallest allowable increment of price movement for a contract. Also referred to as minimum price fluctuation.

Time Limit Order

A customer order that designates the time during which it can be executed.

Time Value (options)

The amount of money option buyers are willing to pay for an option in the anticipation that, over time, a change in the underlying futures price will cause the option to increase in value. In general, an option premium is the sum of time value and intrinsic value. Any amount by which an option premium exceeds the option's intrinsic value can be considered time value. Also referred to as extrinsic value and option premium.

Trading P&L

Trading P&L is the P&L that results from trading activity alone. If you have no position in a stock, trade for the day and leave with no position, your entire P&L will be trading P&L. The larger the position you have at day's

end, the greater the odds that the P&L will be more position P&L than trading P&L.

U

Underlying

The primary instrument, product or commodity from which a derivative is created. Usually the derivative is settled by the price of the underlying contract, or by delivery of the underlying contract.

Underlying Futures Contract

The specific futures contract that is bought or sold by exercising an option.

Underlying Volatility

A moving average of price changes that gives a number reflecting the volatility of price changes. The number ranges from 25 to 75 in most equity options.

Unsecured Debit

Brokers hate this. If your trading account has a negative balance and you have no funds or securities elsewhere for liquidation to pay the debit, your broker uses this term along with a few others not in this glossary.

Uptick

This is a transaction that is executed at a higher price than the previous different transaction (see downtick definition for more details).

U.S. Treasury
Bill

A short-term U.S. government debt instrument with an original maturity of one year or less. Bills are sold at a discount from par with the interest earned being the difference between the face value received at maturity and the price paid.

U.S. Treasury
Bond

Government-debt security with a coupon and original maturity of more than 10 years. Interest is paid semiannually.

U.S. Treasury
Note

Government-debt security with a coupon and original maturity of one to 10 years.

V

Variation Margin

During periods of great market volatility or in the case of high-risk accounts, additional margin deposited by a clearing member firm to an exchange clearinghouse.

Vega (options)

The dollar change in the value of a position as the implied volatility is adjusted by one point.

Vertical Spread

Buying and selling puts or calls of the same expiration month but different strike prices.

Volatility

A measurement of the change in price over a given time period. It is often expressed as a percentage and computed as the annualized standard deviation of percentage change in daily price. An option price creates an implied volatility for that option that may be higher or lower than a volatility calculation for the underlying instrument.

Volume

The number of shares or contracts that trade. This is usually expressed as daily volume. If person X buys one option from Y, this creates a volume of 1.

W

Wheel (options)

The wheel is an automatic trade delivery mechanism for small orders. The originating broker will send an order via computer to the exchange and the exchange will execute the order against the current bid/offer on the screen. The other side of the trade is assigned to traders who have signed up to be on the wheel. The wheel delivers the trade to the next trader in line, then goes through the list, starting again at the beginning.

Wings (options)

These are out-of-the-money calls and puts (or their synthetic equivalent) with a delta of about 20 or less. Long wing positions are generally viewed as insurance against short at-the-money positions and the 'insurance' value of wings usually places the puts above their normal distribution value. Buy-writers generally keep the call wings at or below value because they believe that as a stock moves up, the volatility will generally drop.

Wired

Able to access inside information, or party to information not generally known that will affect the markets. Thus, some orders can be “wired.”