

# **INSURANCE**

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

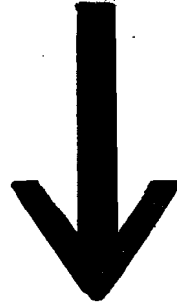
# COMMODITY OPTIONS MARKET

Market in which producers may  
purchase the "opportunity" but not the  
"obligation" to sell or buy a commodity<sup>Futures</sup>  
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**

- DIFFERENCE BETWEEN THE STRIKE PRICE OF THE OPTION AND THE PRICE OF THE UNDERLYING COMMODITY**
- 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	<sup>40</sup> \$0.60
- Original premium paid	<u>-0.15</u>
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	<u>-0.15</u>
Net Returns	\$0.35