

Bradford & Co., Incorporated

presents...



Futures trading is not for everyone. The risk of loss in trading commodities can be substantial: therefore, carefully consider whether such trading is suitable for you in light of your financial condition.

Hedging With Options 101

An online tutorial by Christopher B. Swift



Futures trading is not for everyone. The risk of loss in trading commodities can be substantial: therefore, carefully consider whether such trading is suitable for you in light of your financial condition.

Definition of a Futures Contract

- A futures contract is an agreement between two people, one agrees to make delivery (seller) and one agrees to take delivery (buyer) of a specific commodity of uniform quantity and quality on a specific date in the future at a price that is established upon entry of the contract.

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Definition of a Hedge

- The initiation of a position in a futures or options market that is intended as a temporary substitute for the sale or purchase of the actual commodity.

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Contract Specifications

- **Live Cattle** - 40,000 lbs. of 55% choice, 45% select
USDA grade live steers
\$1.00/ cwt = \$400.00 - Min. Tick is 2.5 = \$10.00
- **Feeder Cattle** - 50,000 lbs of 700-799 lbs. steers
\$1.00/ cwt = \$500.00 - Min. Tick is 2.5 = \$12.50
- **Corn** - 5,000 bushels of #2 yellow corn
\$0.10/ bushel = \$500.00
Min. Tick is 1/4 of 1 cent = \$12.50

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Definition of an Option on a Futures Contract

- An option on a futures contract gives the buyer the right but not the obligation to exercise the call option (the right to buy the underlying futures contract) or put option (the right to sell the underlying futures contract) at a specific price called the strike price at anytime prior to the expiration date of the option.

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Option premiums are priced according to:

- Proximity of the underlying futures contract to the strike price
- Length of time to expiration
- Volatility of underlying futures contract

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What Is Your Breakeven Price?

- Inventory Costs
- How much capital do you have invested in your herd?
- Breeding Costs
- Feed Costs
- Labor, Vet, Supplies, Interest on Borrowed Money
- Machinery, Buildings, Fences?

Calculated accurately, knowing these and other costs, that you may incur, will help you make sound business decisions when it comes time to hedge your product.

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Establishing a Minimum Selling Price



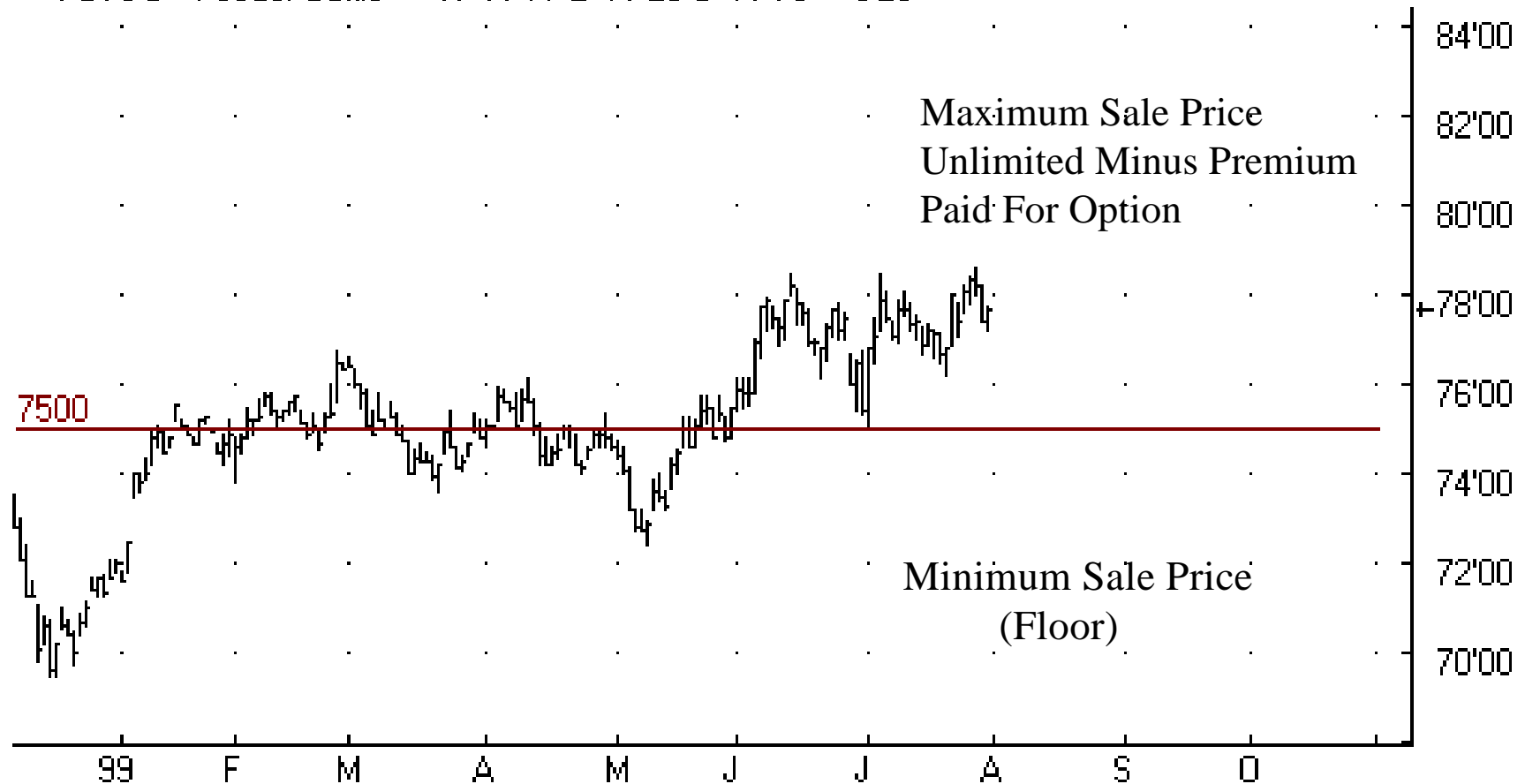
The following worksheets will help you calculate these critical price levels. There will be an example of each, followed by blank ones for you to complete.

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Example I

This chart, October '99 Feeder Cattle, is used for the first example.

▶ FCV9 D Feeder Cattle H=77'77 L=77'25 C=77'70 +0'28



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Worksheet I (Example)

(This is a hypothetical example given for reference only. Feel free to call Chris if you have any questions on how to use these worksheets. 1-800-522-7309)

Finished Steer / Heifer @ 700-800 lbs.

Cost of Gains Break-even \$ 68.00

Date Cattle will be Finished? October

Today's Price of October Futures \$ 77.75 /cwt.

Futures Option:

Strike Price = \$ 76.00

Premium Paid = \$ 1.00

Minimum Sale Price = \$ 75.00

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How to figure Hedge (P&L) at the end of a sale. (Example)

(1) High Price Projection

Add \$5.00 or more to the current futures
to get the hypothetically projected

underlying futures price \$ 82.75

Minus Option Strike Price - \$ 76.00

Equals Option Value \$ 0.00

Option Value \$ 0.00

Minus Premium - \$ 1.00

Equals P&L \$ (1.00)

Cash Sale \$ 82.75

Plus or Minus Option P&L \$ (1.00)

Equals Net P&L \$ 81.75

(2) Low Price Projection

Subtract \$5.00 or more to the current futures
to get the hypothetically projected

underlying futures price \$ 72.75

Minus Option Strike Price - \$ 76.00

Equals Option Value \$ 3.25

Option Value \$ 3.25

Minus Premium - \$ 1.00

Equals P&L \$ 2.25

Cash Sale \$ 72.75

Plus or Minus Option P&L \$ 2.25

Equals Net P&L \$ 75.00

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Worksheet I

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Finished Steer / Heifer @ 700-800 lbs.

Cost of Gains Break-even _____

Date Cattle will be Finished? _____

Today's Price of _____ Futures \$_____/cwt.

Futures Option:

Strike Price = \$_____

Premium Paid = \$_____

Minimum Sale Price = \$_____

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How to figure Hedge (P&L) at the end of a sale.

(1) High Price Projection

Add \$5.00 or more to the current futures
to get the hypothetically projected

underlying futures price \$ _____

Minus Option Strike Price **-\$ _____**

Equals Option Value \$ _____

Option Value \$ _____

Minus Premium **-\$ _____**

Equals P&L \$ _____

Cash Sale \$ _____

Plus or Minus Option P&L **\$ _____**

Equals Net P&L \$ _____

(2) Low Price Projection

Subtract \$5.00 or more to the current futures
to get the hypothetically projected

underlying futures price \$ _____

Minus Option Strike Price **-\$ _____**

Equals Option Value \$ _____

Option Value \$ _____

Minus Premium **-\$ _____**

Equals P&L \$ _____

Cash Sale \$ _____

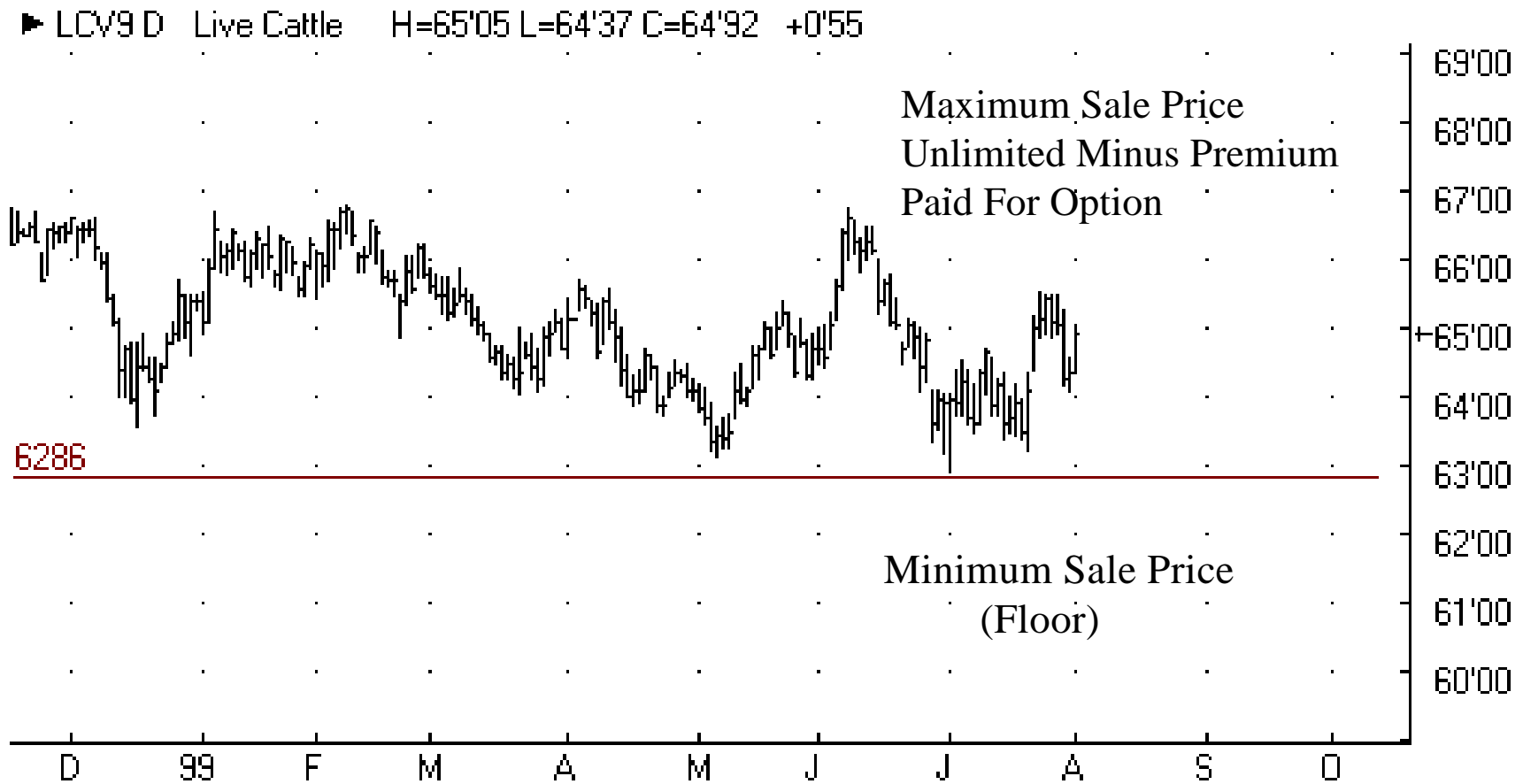
Plus or Minus Option P&L **\$ _____**

Equals Net P&L \$ _____

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Example II

This chart, October '99 Live Cattle, is used for the next example.



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Worksheet II (Example)

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Cattle on Feed

Cost of Gains Break-even \$ 63.00

Date Cattle will be Finished? October

Today's Price of October Futures \$ 64.37 /cwt.

Futures Option:

Strike Price = \$ 64.00

Premium Paid = \$ 1.15

Minimum Sale Price = \$ 62.85

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How to figure Hedge (P&L) at the end of a sale. (Example)

(1) High Price Projection

Add \$5.00 or more to the current futures
to get the hypothetically projected

underlying futures price \$ 69.50

Minus Option Strike Price - \$ 64.00

Equals Option Value \$ 0.00

Option Value \$ 0.00

Minus Premium - \$ 1.15

Equals P&L \$ (1.15)

Cash Sale \$ 69.50

Plus or Minus Option P&L \$ (1.15)

Equals Net P&L \$ 68.35

(2) Low Price Projection

Subtract \$5.00 or more to the current futures
to get the hypothetically projected

underlying futures price \$ 59.50

Minus Option Strike Price - \$ 64.00

Equals Option Value \$ 4.50

Option Value \$ 4.50

Minus Premium - \$ 1.15

Equals P&L \$ 3.35

Cash Sale \$ 59.50

Plus or Minus Option P&L \$ 3.35

Equals Net P&L \$ 62.85

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Worksheet II

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Cattle on Feed

Cost of Gains Break-even _____

Date Cattle will be Finished? _____

Today's Price of _____ Futures \$_____/cwt.

Futures Option:

Strike Price = \$_____

Premium Paid = \$_____

Minimum Sale Price = \$_____

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How to figure Hedge (P&L) at the end of a sale.

(1) High Price Projection

Add \$5.00 or more to the current futures
to get the hypothetically projected

underlying futures price \$ _____

Minus Option Strike Price **-\$ _____**

Equals Option Value \$ _____

Option Value \$ _____

Minus Premium **-\$ _____**

Equals P&L \$ _____

Cash Sale \$ _____

Plus or Minus Option P&L **\$ _____**

Equals Net P&L \$ _____

(2) Low Price Projection

Subtract \$5.00 or more to the current futures
to get the hypothetically projected

underlying futures price \$ _____

Minus Option Strike Price **-\$ _____**

Equals Option Value \$ _____

Option Value \$ _____

Minus Premium **-\$ _____**

Equals P&L \$ _____

Cash Sale \$ _____

Plus or Minus Option P&L **\$ _____**

Equals Net P&L \$ _____

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Establishing a Maximum Purchase Price

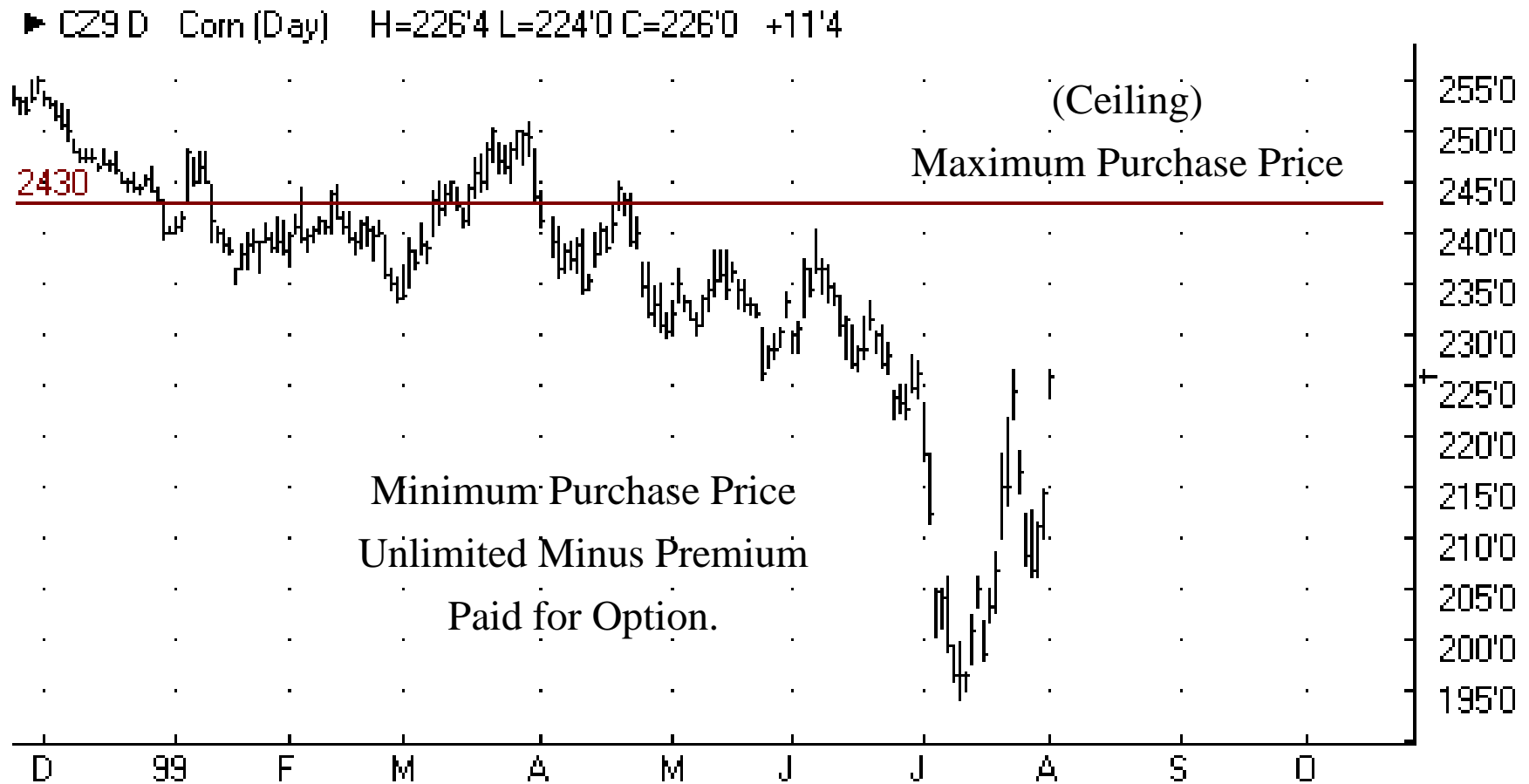


The last worksheet will help you calculate this critical price level.

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Example III

This chart, December '99 Corn, is used for the last example.



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Worksheet III (Example)

(This is a hypothetical example given for reference only. Feel free to call Chris if you have any questions on how to use these worksheets. 1-800-522-7309)

Purchasing Feed Corn

Cash Price \$ 2.10

Date of Future Purchase? December

Today's Price of December Futures \$ 225.50/cwt.

Futures Option:

Strike Price = \$ 2.30

Premium Paid = \$.13

Maximun Purchase Price = \$ 2.43

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How to figure Hedge (P&L) at the end of a sale. (Example)

(1) High Price Projection

Add \$0.50 or more to the current futures
to get the hypothetically projected

underlying futures price \$ 2.60

Minus Option Strike Price - \$ 2.30

Equals Option Value \$.30

Option Value \$.30

Minus Premium - \$.13

Equals P&L \$.17

Cash Purchase \$ 2.60

Plus or Minus Option P&L \$ (.17)

Equals Net P&L \$ 2.43

(2) Low Price Projection

Subtract \$0.50 or more to the current futures
to get the hypothetically projected

underlying futures price \$ 1.60

Minus Option Strike Price - \$ 2.30

Equals Option Value \$ 0.00

Option Value \$ 0.00

Minus Premium - \$.13

Equals P&L \$ (.13)

Cash Purchase \$ 1.60

Plus or Minus Option P&L \$.13

Equals Net P&L \$ 1.73

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Worksheet III

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Purchasing Feed Corn

Cash Price _____

Date of Future Purchase? _____

Today's Price of _____ Futures \$_____/cwt.

Futures Option:

Strike Price = \$_____

Premium Paid = \$_____

Maximum Purchase Price = \$_____

Futures trading is not for everyone. The risk of loss in trading commodities can be substantial: therefore, carefully consider whether such trading is suitable for you in light of your financial condition.

How to figure Hedge (P&L) at the end of a sale.

(1) High Price Projection

Add \$0.50 or more to the current futures
to get the hypothetically projected

underlying futures price \$ _____

Minus Option Strike Price **-\$ _____**

Equals Option Value \$ _____

Option Value \$ _____

Minus Premium **-\$ _____**

Equals P&L \$ _____

Cash Purchase \$ _____

Plus or Minus Option P&L **\$ _____**

Equals Net P&L \$ _____

(2) Low Price Projection

Subtract \$0.50 or more to the current futures
to get the hypothetically projected

underlying futures price \$ _____

Minus Option Strike Price **-\$ _____**

Equals Option Value \$ _____

Option Value \$ _____

Minus Premium **-\$ _____**

Equals P&L \$ _____

Cash Purchase \$ _____

Plus or Minus Option P&L **\$ _____**

Equals Net P&L \$ _____

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What's Next?

Now that you have seen how hedging can work for you, here's why you should implement a hedging strategy.

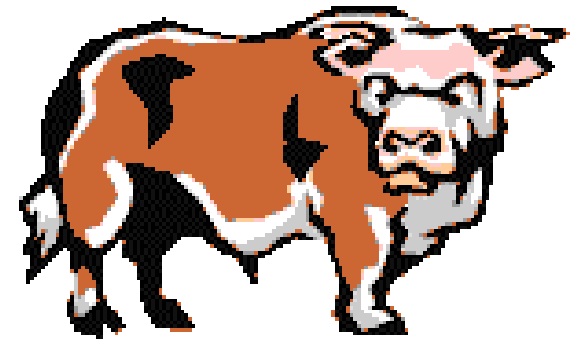
Producers and consumers of commodity goods have learned that an ounce of prevention is worth a pound of cure. They know that being **proactive** in their operations saves time, labor and most importantly...money.

Those who choose not to be **proactive** are left vulnerable to unpredictable market conditions and must **react** to unfavorable price movements, unfortunately by then, it may be too late.

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Proactive

- Proper Nutrition
- Proper Health Applications
- Good Living Conditions
- A Marketing Strategy...



Cash Forward

Futures

Options

Contract

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Reactive

- Going to sale and find out you weren't very proactive.
- A little planning today, can make all the difference tomorrow.



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Areas of Concern

- **What is my initial investment?**

Options: A one time premium per option.

Futures: An initial margin requirement plus any additional maintenance margins required.

- **What are the fees for service?**

\$50.00 round turn per contract or per option.

- **What can I lose?**

Options: 100% of the premium paid per option.

Futures: Unlimited risk.

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How to Get Started

- Request written material on pertinent markets that you are interested in.
- Write down any questions you may have.
- Ask people who are already hedging, the broker of your choice, or call me @ 1-800-522-7309 or e-mail at chris.swift@jcbradford.com

Thank you for your participation.

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