

SECURITIES TRAINING CORPORATION

Series 3

Crunch Time Facts

The Crunch Time Facts are a collection of statements we believe are valuable as you engage in the final preparation to sit for your examination. These facts are not designed to raise questions, but instead to be part of your final review used with any notes created during your studies.

Chapter

Facts

- 1** Both parties to a futures contract have obligations.
 - Contracts call for delivery from locations and at times that are specified in exchange rules.
 - Contracts may allow for delivery of superior grade – for a premium; or inferior grade – at a discount.
 - Place of delivery and acceptable locations (referred to as “regular for delivery warehouses”) must be approved by the Exchange.
 - Speculators will cause higher liquidity and narrower price spreads.
 - Floor brokers execute orders on behalf of others.
 - Floor traders (also referred to as locals) trade for their own account.
 - The clearinghouse becomes the buyer for every seller, and the seller for every buyer, thereby eliminating counter-party risk.
 - Globex is an electronic platform for trading futures and options and is owned and operated by the CME.
 - Electronically traded CME Globex products are interchangeable with floor-traded CME products.
 - Side-by-side contracts trade simultaneously on CME Globex electronically and on the trading floor through open outcry.
 - A futures contract that is traded on the ICE (Intercontinental Exchange) in London is interchangeable with a futures contract that is traded on a futures exchange in New York.
- 2** An AP is responsible for ensuring that the risk disclosure document is signed and dated at or prior to an account being opened.
 - For some customers, the best disclosure statement is that trading futures is too risky.
 - Spread positions should not be described as having little risk.
 - An Option Disclosure Document must include the components that make up the option premium (i.e., time value and intrinsic value), but not the actual premium.
 - If a customer refuses to disclose certain personal information, his account may still be opened.
 - A margin agreement must be signed by all clients; there is no cash account for commodities.
 - A transfer agreement, also referred to as a supplementary agreement, allows an FCM to transfer funds to/from a client’s securities account.
 - FCMs must maintain net capital that is equal to or in excess of \$1,000,000.
 - IBs must maintain net capital that is equal to or in excess of \$45,000.
 - NFA members must keep books and records for five years.
 - Speculative position limits only apply to speculators.
 - Position reporting limits apply to both speculators and hedgers.
 - If no transfer agreement was signed, an FCM must obtain the client’s specific, written approval for each transfer.
 - An AP must have two years of experience in order to handle a discretionary account (unless the AP is a CTA).
 - Churning is defined as excessive trading in an account in an effort to generate commissions.

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- The allocation of bunched orders is not required to be specified by the CTA at the time of order entry.
- The allocation of bunched orders must be done by the CTA or the account manager before the end of the day.
- The allocation of bunched orders is subject to fair, equitable, and non-preferential standards.
- A CPO may use a disclosure document for 12 months from the effective date.
- An associated person may have his registration held by two FCMs (dual registration) provided approval is obtained from both firms.

3 The support is the level at which prices tend to stop falling.

- The resistance is the level at which prices tend to stop rising.
- Congestion is when prices are trapped in a trading range.
- A breakout occurs when prices break through an area of support or resistance.
- A breakout of an area of support is a bearish indicator.
- A breakout of an area of resistance is a bullish indicator.
- In order to profit on a breakout, a person may 1) enter sell stop orders below a support level or 2) buy puts.
- In order to profit on a breakout, a person may 1) enter buy stop orders above a resistance level or 2) buy calls.
- A head and shoulders (Top) formation is a reversal of an upward trend and is a bearish indicator.
- An inverted head and shoulders (Bottom) formation is a reversal of a downward trend and is a bullish indicator.
- Prices between cash and futures must converge by the first day delivery.
- If cash and futures' prices do not converge on the first delivery day, an arbitrage opportunity will exist. As a result of arbitrage activity, prices will then converge..
- Carrying charges include storage, insurance, and interest.
- In a normal market, prices rise as you go further out in futures.
- In an inverted market (backwardation), prices lower as you go further out in futures.

4 Treasury notes and bonds (long-term financials) have a par value of \$100,000.

- Treasury notes and bonds (long-term financials) are quoted as percentage of par and 1/32.
- 1% of \$100,000 is \$1,000 and 1/32nd of \$1,000 is \$31.25.
- T-Note and T-Bond option premiums are quoted in 1/64th of \$1,000, which is \$15.625.
- Treasury bills and Eurodollars (short-term financials) have 13-week (3 months) maturities and a par value of \$1,000,000.
- Treasury bills and Eurodollars are quoted in terms of basis points and one basis point equals \$25.
- There are 100 basis points in one point or 1%.
- Grains (e.g., corn, wheat, and soybeans) have 5,000 bushels per contract.

5 Both stop and stop limit orders are "triggered" (activated) when a contract trades at, or through, the stop price.

- Buy Stop orders are placed above the market and are also triggered when bid at the stop price.
- Sell Stop orders are placed below the market and are also triggered when offered at the stop price.
- Once activated, stop orders become market orders.
- Once activated, stop-limit orders become limit orders.

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- Once activated, Market-If-Touched orders become market orders for immediate execution at the market price.
- 6** Margin is established by the Exchange and is set at the same percentage for both long and short positions.
 - Hedging margin is usually lower than speculation margin.
 - Margin requirements are calculated daily and are based on the contract's settlement value.
 - Settlement value is not always considered the last trade.
 - If equity falls below the maintenance level, the client is only required to bring the equity back to the original margin.
 - Clients may only withdraw the portion of equity which is greater than the initial margin (i.e., excess equity).
 - Excess equity may also be used to meet margin on new positions – referred to as pyramiding.
 - If the Exchange changes margin requirements, the change applies to all contracts.
- 7** Speculators buy and sell for the purpose of making profit.
 - Speculators take long positions (buy futures) when they anticipate a rise in prices.
 - Speculators take a short positions (sell futures) when they anticipate a decline in prices.
 - Speculators add liquidity to markets and reduce price volatility.
 - Round turn commissions include two transactions (i.e., a buy and a sell).
 - Commissions reduce gains (i.e., subtract).
 - Commissions increase losses (i.e., add).
 - Half turn commissions are for one transaction.
 - An inverse relationship exists between bond prices and interest rates.
- 8** Spreads are created by selling one futures contract and purchasing another.
 - Intramarket or InterDelivery Spreads have the same commodity exchange, but different months.
 - Intermarket Spreads have the same commodity and month, but different exchanges.
 - Intercommodity Spreads have different commodities (e.g., corn/wheat, gold/silver, etc.).
 - With Commodity Product Spreads, investor take one position in the raw material, and an opposite position in the by-products.
 - The Crush: Buy Soybeans and Sell Soybean Oil and Meal.
 - The Crack: Buy Crude Oil and Sell Gasoline and Heating Oil.
 - Generally, a spreader's market sentiment is reflected in his position in the near month.
 - For most spread positions, if a spreader is bullish, he will buy (go long) the near month; however, if bearish, he will sell (go short) the near month.
 - For stock index futures and foreign currency spreads, the spreader's sentiment is indicated by his position in the deferred month.
 - If a spread trader bought (went long) the more expensive leg, he wants the spread to WIDEN.
 - If a spread trader sold (went short) the more expensive leg, he wants the spread to NARROW.
 - A Note over Bond (NOB) spread is created by offsetting positions in 30-year Treasury bond futures and 10-year Treasury note futures.
 - If long-term interest rates are falling faster than intermediate-term interest rates, a trader would establish an NOB spread by shorting T-Note futures and going long T-Bond futures.
- 9** Through hedging, producers and users may pass most of the risk of price change to speculators.
 - Basis represents the relationship between cash and futures' prices.
 - It is normal for cash to be less than futures (i.e., cash under).

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- A strengthening basis is positive if long the commodity (a producer).
- A weakening basis is positive if short the commodity (a user).
- Producers have an effective selling price.
- $\text{Effective selling price} = \text{Cash Now} + \text{Profit on the Hedge OR Cash Now} - \text{Loss on the Hedge}.$
- Users have an effective cost.
- $\text{Effective cost} = \text{Cash Now} - \text{Profit on the Hedge OR Cash Now} + \text{Loss on the Hedge}.$
- 10** Index futures are used to hedge positions against systematic risk .
- Index contracts use a multiplier to convert an index value or average into a dollar value.
- Index contracts are settled for cash.
- 11** Calls provide a buyer with the right to buy a futures contract at a preset price.
- Calls obligate a seller to sell a futures contract at a preset price.
- Puts provide a buyer with the right to sell a futures contract at a preset price.
- Puts obligate a seller to buy a futures contract at a preset price.
- Calls are in-the-money when the market is UP above the strike price.
- Puts are in-the-money when the market is DOWN below the strike price.
- $\text{Premium} = \text{Intrinsic Value} + \text{Time Value}.$
- An option's intrinsic value is equal to its in-the-money amount.
- An option has zero intrinsic value if it is out-of-the-money or at-the-money.
- $\text{Time Value} = \text{Premium} - \text{Intrinsic Value}.$
- An option's time value is based on the time left until expiration and the volatility of the underlying commodity.
- An option's premium is set in the marketplace (i.e., it is negotiated).
- Long straddle involves buying both a call and put; for investors seeking volatility.
- Short straddle involves selling both a call and put; for investors expecting stability.
- $\text{Synthetic Long Call} = \text{Long Put} + \text{Long Futures}.$
- $\text{Synthetic Long Put} = \text{Long Call} + \text{Short Futures}.$
- $\text{Synthetic Long Futures} = \text{Long Call} + \text{Short Put}.$
- $\text{Synthetic Short Futures} = \text{Long Put} + \text{Short Call}.$
- $\text{Conversion} = \text{Long Futures} + \text{Long Put} + \text{Short Call}.$
- $\text{Reversal} = \text{Short Futures} + \text{Long Call} + \text{Short Put}.$
- European-style option contracts may only be exercised on the business day prior to expiration.
- American-style option contracts may be exercised any time during their life.
- An order must be time stamped within one minute of receipt by the FCM.