In This Issue

Managing Risk Through Options

The original and perhaps best use for options is as a hedge against adverse price movement. Options give the futures market trader an alternative venue for managing his overall risk. Purchasing the right to buy or sell a commodity at a known price is a hard-won luxury for producers, manufacturers and traders. Commodity options have had a rocky history, but it is exactly that long series of trials and errors that has brought about the relatively stable markets we enjoy today.

Some History on Options:

Options were originally traded in the grain markets back in the late 1800s and continued into the great depression through the early 1930s. The exchanges, particularly the Chicago Board of Trade and the Open Board of Trade, alternated between approval and disapproval. The question of whether "privilege" trading was, in fact, "option" trading was addressed by the Illinois Supreme Court. Regardless of what it was called, options trading was popular both on and off the trading floor.

Despite its popularity, the overall image of the options business was less than respectable and in 1910 the Federal Government became involved to protect the public. Rules were modified by the exchanges to guarantee a form of cash settlement and to develop a plan of accountability. The government attempted to cure certain public objections by imposing a heavy tax on all exchange-traded commodity options transactions. This tax quite literally killed options trading for a time, but it rebounded in 1926 when the tax was declared unconstitutional by the U.S. Courts.

From 1926 until 1933, exchange-style options trading flourished, representing ten percent of futures trading volume. However, the tumultuous summer of '33 in the CBT wheat pit brought more government intervention. On July 19th, the July CBT wheat contract completed a move from around 44.5 cents per bushel at the start of the year, to $1.175. The following day, a dramatic drop brought the market back down to 90 cents. Trading was suspended for two days following the drop so the exchanges could recover from an "an enormous amount of book work and an exhausted staff."

It was rumored that the drop was caused by a single private speculator who cornered the wheat market through the cunning use of call "privileges." A Chicago crop authority contradicted this with the conclusion that the drop was "fully justified by legitimate conditions of supply and demand," which stemmed from a severe drought and crop failures. The turbulent advance and subsequent drop of the wheat market were reported to have been caused by a public fear that food shortages would occur and a general
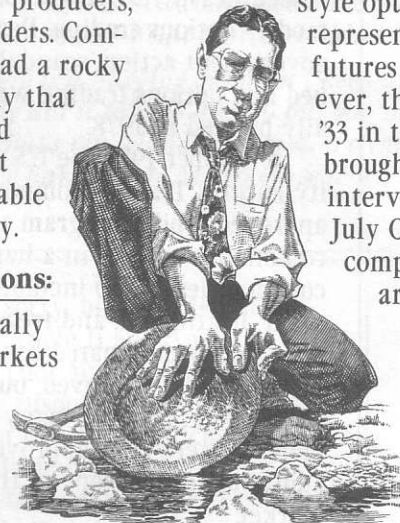
> *"...options offer many investment alternatives that foster sound, informed technical trading in the futures complex."*

misunderstanding of economic forces. On July 24 1933, the Chicago Board of Trade moved to prevent such volatility in the future by imposing daily trading limits on grains and Provisions.

The crop authority's assessment not withstanding, federal legislators considered the wild markets to be the result of excessive speculation. The resulting political pressure contributed to serious controls that were legislated into The Commodity Exchange Act of 1936. The new laws placed heavy restrictions on commodity options trading. Despite government action, scandals continued and options trading was eventually banned in 1978.

In October 1982 the U.S. Commodity Futures Trading Commission approved a pilot program to trade commodity options in a handful of commodities. These included gold, sugar, heating oil, and treasury bonds. Only designated contracts were initially approved, but, as most observers are aware, many more markets were later approved as additions to the scope of this "new" market.

Rules, regulations and controls have been imposed out of the excesses of the past which may make options trading a more permanent success. If the number of markets and active contracts which have options is any barometer, one would have to conclude that options trading is finally here to stay. Let's hope that this is the case because options offer many investment alternatives that foster sound, informed technical trading in the futures complex.

What Purpose do Options Serve?

Purchasing an option to buy or to sell a product crucial to a transaction is a fundamental hedge that fosters good and expedient business. Many transactions would not be possible

without the prerequisite planning offered by an option. The historical objection to options or privileges has mostly centered around group or exchange-style trading where standardized products are bought and sold. The general purpose of the options market is to offer protection against adverse price fluctuations for a premium price giving one the right, but not the obligation, to buy or sell a given product at a specific price. Each option has a known expiration date and may be exercised on or before that date.

In the trading arena, options take on an added dimension by giving the futures market trader an alternative avenue for managing his overall risk. Options can be used to protect against loss in a speculative transaction much like a trailing stop protects against excessive losses. On the other hand, purchasing an option might be a trader's primary method of taking a speculative position that anticipates price change in a given direction. Similarly, writing an option (either a put or call that you believe will expire valueless) is a technique used by savvy option traders to gain the full premium. All of these alternative strategies should be considered before deciding on the composition of a given market position.

Losses in a speculative position are usually market orders that are triggered by an adverse price correction in a direction that is contrary to your original position. This reverse market order, called a "stop," often translates into a loss with significant slippage. In other words, the market-order fill is often far from the stop-loss price. On the other hand an option offered at a price near to your intended stop will be priced with a premium that could be comparable to the dollar slippage of an open-market-order stop and also act as a

Avoid Gaps in On-Demand History

We have worked out most of the kinks in our "On-demand" history service which is available through QuickTrieve version 4.05. If you have used this new service, you know that it allows for immediate drawdown of historical data via modem as soon as an order is received. We hope to clear up remaining problems with consistent availability and concurrent portfolio changes shortly. We also expect to make Perpetual Contract data and other "computed" contracts such as cash and nearest futures available within the next month or two. Feedback from our customers has helped us tremendously in improving this service and addressing your needs.

One important factor that all users of on-demand history should consider is the timing of your order. Failure to order data at the right time or in the right sequence can result in gaps in your data files. Please be aware that history on demand will always exclude the current business day until after 8 p.m. eastern time. Whenever today's prices are required before 8 p.m., be sure to add the item to your portfolio before your daily update retrieval session. This will fill in current prices and assure continuity.

Prior to March 28, the most recent update was available as history in the morning of the following business day. If you have received history on-demand and feel you may have developed gaps, please check your files either manually or through QuickTrieve's Data Integrity Checker. Use QuickTrieve's daily update routine to re-collect any individual days that are missing.

Our accounting procedure allows for 26 updates during a month, which are usually four or five more than are required for retrieving each business day. Therefore recollection is unlikely to add extra charges on

Ode to an Old, Old Apple

In the days before the hard drive and even the PC,
Dear Apple II computer, you meant the world to me.
You'd store all my data on those spiffy floppy disks,
You would define the decade, oh I was sure of this!

Your decade was a little short, and sadly, it has gone.
My Apple II computer seems lost and so forlorn.
I can't buy software upgrades; Forget tech support.
When your programs fail, the message is "abort."

Goodbye to you, my Apple, my first computer friend.
You taught me how to copy disks and plug a modem in.
I've bought a new computer now. It's called a PC clone.
What power! What a price! I didn't need a loan!

There is a nagging question I keep asking of myself:
Why did it take so long to put you on a shelf?
Perhaps my fellow traders who cling to Apples know
How hard it is to say goodbye when it's time to go.

S.C.

We are sorry, but CSI's technical support of Apple II and Apple III computers (not Macintosh) has been completely suspended. We gave our last modem to a stranded customer and have dismantled most of our other systems for the same reason. Those Apple II and III users who are currently on line may continue updating as usual, but without benefit of our customer support line.

We invite our Apple II and Apple III customers to upgrade to the Macintosh or PC for full support and service. CSI will waive the $59 software fee for all Apple-to-IBM or -Mac upgrades. Replacement history for the PC is available at a 50% discount off our new low data disk rates. Please call our service department for details. ✦

Ask Customer Service

Q. *I want to order a new commodity for history and updates. Unfortunately, I don't know the CSI number and I've misplaced my fact sheets. Do I have to call the service department to order this data?*

A. Although you may call customer service to complete your order, a simpler, more economical route may be to look up the number yourself while ordering through QuickTrieve's Order Subsystem. After selecting either <A> Change user portfolio or <B> Order historical information and entering C for commodity, you can view the list of available commodities. Press <F5> to activate the listing. Use the arrow keys to scroll through the numerical list or search by name or symbol. Once you select a commodity, it is automatically added to your order form where you may supply additional information as required.

Q. *I'm trying to order a stock for which I know neither the ticker symbol nor the CSI number. Every time I press <F5> Select one stock/ commodity to search for it, I get the commodity list. How can I switch to the stock list?*

A. The list that is presented depends on your entry in the "Com or stock" column. The default is C for commodities. To view a the stock listings, change the C to S before pressing <F5>.

Q. *How is the "Add stocks" entry on the Change User Portfolio screen different from the <F5> Select one stock/commodity?*

A. They are the same for adding stocks, except that with the <F2> option, you can select multiple stocks individually or by page. Please don't use the "select all" option, as each

custom portfolio User ID can accommodate only 1,000 of our 7,500 stock issues. Commodities cannot be added in simple groupings like this because of the variable delivery months, rollover dates, etc.

Q. *Is there an easy on-line method of reviewing the information found in the CSI Fact Sheets?*

A. The commodity and stock lists used in the Order Subsystem supply sort of an abbreviated fact sheet, with the added bonus of a "search" feature. Whether or not you want to order data, you may access these lists through the <A> Change user Portfolio or <B> Order historical information selections as described above.

The stock list includes such information as the CSI number, the name (possibly abbreviated) the ticker symbol, the conversion factor and the exchange where traded. An empty field is reserved for industry codes which will be activated later.

The commodity list includes the CSI number, the commodity name, the symbol, unit of measure and conversion factor. Additional information such as the normal trading months, first day on file, maximum months forward, etc. can still be found in our fact sheets.

When using the Order Subsystem to look up information without ordering, avoid actually selecting commodities or stocks for inclusion on your electronic order form. If entries are inadvertently added there, be sure to erase them before sending your next transmission to CSI. ✦

short-term appreciable asset.

When an option is used as a stop, it immediately becomes a potential short-term asset for later premium appreciation should the market continue in its hoped-for direction and later retrace its path. For example, a long position in June Live Cattle might have been taken at perhaps 58 cents per pound. As the market moved to, say 70 cents per pound, you may have purchased protective June puts at nominal striking prices of 60, 64 and 68 cents as the parent market advanced. If live cattle retreated from 70 cents to 67 you would have exercised your 68 put to both cover and assume an opposite short position. As the market continued to move lower, the premium would have advanced on the other puts converting them into a valuable asset tempered by the option's still-present time value.

Knowing 1) the time value of an option, 2) the price proximity of the parent market to the option striking price where the relative premium is high, and 3) the volatility of the parent market will give the trader a reasonable assessment of the option's deserved premium. A simple comparison of the expected premium with the actual premium will expose the option for its relative investment appeal. Knowing whether the option is analytically undervalued and

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CSI Software Product Summary

Please check all that apply and complete the information box at right.
Mail or fax to CSI, 200 West Palmetto Park Road, Boca Raton, Florida 33432; Fax: (407) 392-1379

❑ **QuickTrieve®/QuickManager®** for PC - To retrieve, manage & edit data (includes 1994 Alerts Calendar); Unrestricted use $99. New daily user $59. QuickTrieve/QuickManager version 4.05 upgrade (for current QuickTrieve users only): $39

❑ **QuickPlot®/QuickStudy®** for PC - Charting & analysis software (requires QT/QM) $99

❑ **Trade Data Manager™** - Macintosh downloader & accounting program $59; upgrade $49 or *FREE* with $100 history order.

❑ **Trading System Performance Evaluator™** (TSPE) for PC - Computes your system's capital requirements $199

❑ **Trader's Money Manager™** for PC - Introductory price $499 (includes TSPE)

❑ **TraDesk™** for PC - Traders' complete accounting system-(price varies with number of accounts) Starting @ $399/Unrestricted use $299/Daily data user or 12-month lease starting @ $22/Mo.

❑ **Seasonal Index Value Pack** for PC - Ten years of history for 33 popular commodities $444

❑ **Daily Updates** for PC - Starting at $10.80 per month

❑ **CSI Technical Journal** - Aug. 1990 to present $35/Yr. or $5/ Reprint

❑ **CSI Mailing List** - $200/1,000 names (CSI users omitted)

❑ **CSI Product Catalog** - *FREE*

NAME _____

DAY PHONE (____) _____

ADDRESS _____

_____

_____

USER ID# _____

DISK PREFERENCE

☐ 5.25"/360K   ☐ 5.25"/1.2 MB (HIGH DENSITY)
☐ 3.5"/720K   ☐ 3.5"/1.44 MB (HIGH DENSITY)

METHOD OF PAYMENT (PREPAYMENT REQUIRED)

☐ CHECK   ☐ MASTERCARD/VISA   ☐ AMEX
AMOUNT ENCLOSED $ _____

CARD # _____

EXP. DATE _____

SIGNATURE _____

5/94

All prices subject to change without notice.

knowing the inevitable slippage and commission consequences of entering into a futures position should help to guide the trader into making the lowest risk trading decision whenever the technical/fundamental forces dictate doing so.

A data base structured with all the available elements of each market (all futures contracts, their options and cash), as an integrated set would be ideal for this type of evaluation. The compression technique we have been working on will allow us to provide information in this way, using a minimum of disk space. The project is inching along successfully and should be a great asset to our customers. We will provide more details on this as we move forward.

In the meantime, the trading advantages offered by options should not be overlooked. Whether protecting the unrealized profits of your futures position or building profits of their own, options have a place in nearly all well-managed trading plans. Option trading is a privilege that should not be taken for granted. ✦

Bob Pelletier

Correction:

On page 2 of the April, 1994 CSI Technical Journal:

In explaining Equation 2 ($P(t) = P(0) + at - bt^2$), the description should have said:

"Where b is the coefficient of price deceleration per unit time squared."

"To make the model work for you, "bt^2" must exceed "at" for the t larger than some large T that would be beyond the range of possibilities."

Market Statistics Update

ADDITIONS TO THE COMMODITY DATA BASE

Commodity:	Canadian Government Bond
CSI commodity #:	351 Symbol: CN
Exchange:	CBT
Unit of measure:	Percent Contract size: C$100,000
Delivery months:	3,6,9,12
1st day on file:	940408 CSI point value: C$10.00
Conversion factor:	+2 Newspaper/CSI price:105.49:10549
Limit:	None Max months forward: 12

DELETIONS FROM THE STOCK DATA BASE

8238	BLVD	Boulevard Bancorp Inc
2217	CREI	Care Enterprises Inc
8331	CHOL	Central Holding Co
4842	CHBC	Chattahoochee Bancorp Inc
4519	CNCN	Citizens Nat'l Cp (FL)
2241	CCPI	Comcast Cablevision of Philadelphia Inc
4099	CBOCA	Commercial Bancorp
8451	CSTL	Constellation Bancorp
5844	DMLB	Dickenson Mines Ltd CL B
5843	DMLA	Dickenson Mines Ltd CL A
8601	ELDC	Eldec Cp
2312	EMBR	Embrace Systems Cp
1568	EQXXF	Equinox Resources Ltd
4823	ESBB	ESB Bancorp Inc
8660	FBRX	Fibronics Int'l Inc
3255	HA	HAL Inc
4162	HBSI	Hamptons Bancshares Inc
2418	ISLH	Int'l Holding Capital Cp
2486	MGAW	McGAW Inc
8761	MMGI	Medical Marketing Group Inc
3407	NCN	Norcen Energy Resources Ltd
5855	PWB	Pacific Western Bancshares
9424	PETT	Pettibone Cp
6153	RSPMX	Rushmore Fund/Precious Metals Index Plus Portfolio
8769	SPSC	Spectrascience
9772	TRLS	Thousand Trails Inc
9855	VMXI	VMX Inc

NAME, SYMBOL & EXCHANGE CHANGES

4461	AGCO	Agco Cp - New symbol: AG; New exchange: NYSE.
3015	AEX	Air Express Int'l Cp - New symbol: AEIC; New exchange: OTC.
8187	BKNT	Banker's Note Inc, The - New symbol TBN; New exchange: AMEX.
1594	BSPR	Biospera Inc - New symbol: BSEP.
6290	BCCAX	Boston Capital Appreciation Portfolio (NL) - New name: Boston Company Capital Appreciation Portfolio (NL); New symbol LCAIX.
8256	BSIM	Burnup & Sims Inc - New name: Mastec Inc; New symbol: MASX.
8294	CWTR	California Water Service Co - New symbol: CWT; New exchange: NYSE.
8339	CGOL	Charter Golf Inc - New symbol: ASHW.
5310	CME	CMS Enhancements Inc - New name: Ameriquest Technologies Inc; New symbol: AQS.
2303	EVRO	EVRO Financial Cp - New name: Evro Cp.
7940	FRON	Frontier Adjusters of America Inc - New symbol: FAJ; New exchange: AMEX.
2385	HTPI	H&S Treat & Release Inc - New name: Home Theater Products Int'l Inc.
4278	MQ	Health Systems Int'l Inc CL A - New symbol: HQ.