Futures

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- Futures are derivative financial contracts that obligate the parties to transact an asset at a predetermined future date and price. Here, the buyer must purchase or the seller must sell the underlying asset at the set price, regardless of the current market price at the expiration date.

- Underlying assets include physical commodities or other financial instruments. Futures contracts detail the quantity of the underlying asset and are standardized to facilitate trading on a futures exchange. Futures can be used for hedging or trade speculation.

- Futures—also called futures contracts—allow traders to lock in a price of the underlying asset or commodity. These contracts have expirations dates and set prices that are known up front. Futures are identified by their expiration month. For example, a December gold futures contract expires in December. The term futures tend to represent the overall market.

- However, there are many types of futures contracts available for trading including:
- Commodity futures such as in crude oil, natural gas, corn, and wheat
- Stock index futures such as the S&P 500 Index
- Currency futures including those for the euro and the British pound
- Precious metal futures for gold and silver
- U.S. Treasury futures for bonds and other products

- Pros
- Investors can use futures contracts to speculate on the direction in the price of an underlying asset
- Companies can hedge the price of their raw materials or products they sell to protect from adverse price movements
- Futures contracts may only require a deposit of a fraction of the contract amount with a broker

- Cons
- Investors have a risk that they can lose more than the initial margin amount since futures use leverage
- Investing in a futures contract might cause a company that hedged to miss out on favorable price movements
- Margin can be a double-edged sword meaning gains are amplified but so too are losses

- Futures can be used to hedge the price movement of the underlying asset. Here, the goal is to prevent losses from potentially unfavorable price changes rather than to speculate. Many companies that enter hedges are using—or in many cases producing—the underlying asset.

- A futures contract allows a trader to speculate on the direction of movement of a commodity's price.
- If a trader bought a futures contract and the price of the commodity rose and was trading above the original contract price at expiration, then they would have a profit.