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THE
DEFINITIVE
BEGINNER'S GUIDE
TO THE
FUTURES MARKET

The Definitive Beginner's Guide To The Futures Market

It's a shame the mainstream investment community considers the futures markets taboo. Especially when the greatest investors of all time use futures. Billionaires like Paul Tudor Jones have often called these markets their "favorite". Yet the stigma behind futures have still kept most investors away.

We don't fall victim to the propaganda against futures. We use them as a tool to diversify and enhance our portfolio returns. Futures are actually a big reason we're able to outperform the market.

Yes, futures are financial derivatives. But don't let the term "derivative" scare you. A future's contract is pretty simple. It's just a promise between two people to exchange money for goods at a specified date in the future. It's far easier to understand than the complex CDO and CDS contracts you hear about in the news.

Futures are also closely regulated. Many brokerages allow non-professionals to trade them right alongside stocks and bonds.

Why Invest In Futures?

Futures help investors outperform a typical vanilla stock and bond portfolio. They have four key characteristics that enable them do this:

- 24-hour trading
- Access to commodities and other esoteric assets
- Leverage and capital efficiency
- Favorable tax treatment

24-Hour Trading

Futures trade around the clock from Sunday night to Friday market close. And now that markets have gone 100% electronic, trades can execute at any time.

Have you ever had a stock position that opened up significantly lower? Did the drop prevent you from cutting your loss quickly and getting out? With futures, you don't have this problem. Unlike stocks, you don't have to worry about prices opening too far away from the previous day's close. You can avoid price gaps by executing orders overnight. Investing platforms allow you to place orders that will automatically exit trades if price violates a level you choose. You can sleep peacefully, while letting the computer trade overnight for you.

This feature comes in handy. Remember the summer of 2015? The market experienced a huge panic-inspired gap down on August 24th.



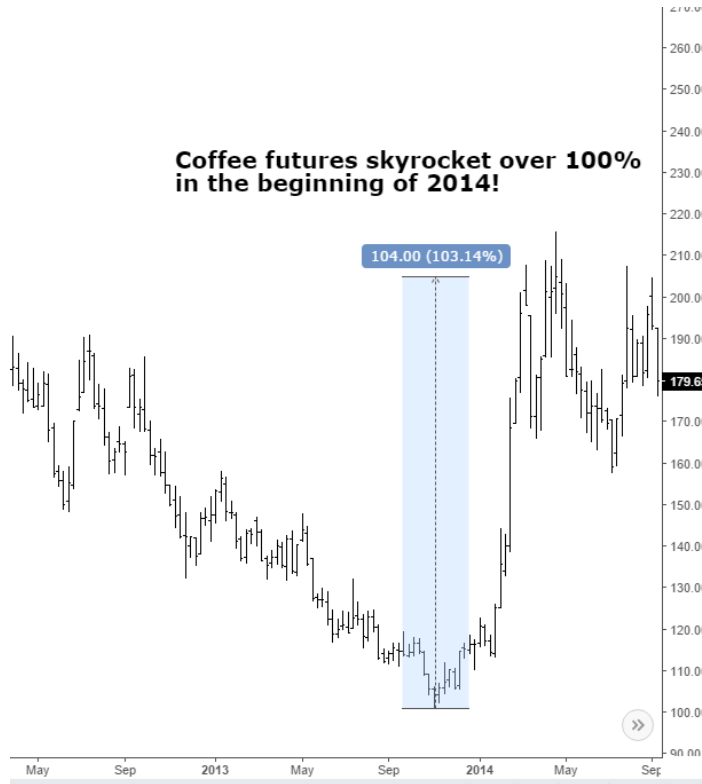
Investors who were long stocks took far worse losses than anticipated. There was no way to exit their positions until the market opened and everyone was underwater. But with access to the futures market, they could have gotten out or hedged positions on Sunday night.

Commodities And Beyond

Futures provide more than just access to overnight markets. They also open doors to new asset classes -- the biggest being commodities.

Ignoring the commodity markets is a massive opportunity cost for investors. Commodities aren't correlated to stocks. That makes them a good tool to further diversify your portfolio. Not only will this cut down your risk, but it will also increase your profits. There's no need to sit there and accept pain whenever a bear market in stocks rolls around. Instead, with access to commodities, you can continue to create returns for your account.

Check out this move in coffee futures at the beginning of 2014:



Or take a look at the more recent sell off in crude oil:



Staying active and up to date in the commodity markets allows you to profit from these types of moves. This is especially important when equity investing goes dry. Investors who pay attention to more markets have a better chance of hitting more large moves.

Beyond commodities, futures also provide exposure to asset classes like currencies and interest rates. These again open up more areas for investors to diversify and profit. The table below lists the most popular futures markets available to trade at retail brokerages.

Interest Rates	Metals	Currency	Grains	Stock Index	Energy	Softs	Forest	Livestock
US-2 Year Note	Gold	Aussie Dollar	Corn	E-mini NASDAQ	Brent Crude Oil	Cocoa	Lumber	Feeder Cattle
US-5 year Note	Silver	British Pound Sterling	Oats	E-mini S&P 500	Gasoline	Coffee	Hardwood Pulp	Lean Hogs
US-10 Year Note	Copper	Canadian Dollar	Soybeans	E-Mini Russell 2000	Heating Oil	Cotton		Live Cattle
US-30 Year Bond	Platinum	Euro	Soybean Meal	E-Mini DOW	Light Sweet Crude Oil	Orange Juice		
	Palladium	Japanese Yen	Soybean Oil	Nikkei 225	Natural Gas	Sugar		
		Mexican Peso	Wheat	CBOE Volatility Index				
		New Zealand Dollar						
		Swiss Franc						
		US Dollar Index						

Leverage And Capital Efficiency

On top of 24-hour trading and commodities, futures offer more leverage than any other financial product. Futures aren't regulated by the same governing body as stocks. They have their own regulations that allow far more leverage than what the SEC allows for stocks. Most retail accounts offer at most 2 to 1 leverage on equities. And other accounts offer no leverage at all. But futures use something called SPAN margining. Without going into too much detail, this type of margin gives investors access to 20 to 1 leverage or more.

The extra leverage is beneficial because it allows investors to take part in the futures markets with small amounts of capital. You end up risking a little to gain a lot! That's the power of leverage.

This capital efficiency also leaves investors extra funds to find even more investment opportunities. And more investment opportunities equals larger profits.

60/40 Tax Treatment

Finally, futures are taxed far more favorably than equities. This is especially true when it comes to short and medium-term investments.

With stock, if your holding period is less than a year, your gains are taxed like ordinary income. To qualify for the lower “long-term capital gains” tax, you would need to hold your position for a year or more.

Futures are different because they fall under the “60/40” rule. This means that regardless of the holding period, 60% of gains are taxed as long-term capital gains and 40% are taxed as ordinary income. For more active traders, this results in an overwhelming tax advantage.

The combination of 24-hour trading, commodity market access, incredible leverage, and tax efficiency make futures a lucrative trading vehicle. With advantages like these, it's not uncommon for the best futures traders to have years with over 100% returns.

Futures Defined

The futures market clearly has a lot of benefits, but what exactly is a futures contract?

In layman's terms, think of a futures contract as a promise between two people. These people agree to exchange money for goods at a specified date in the future.

Or more formally: a futures contract is a standardized agreement to buy or sell a fixed quantity of goods at a specified price at a specific date in the future. “Goods” can be barrels of oil, bushels of wheat, euros, government bonds, etc.

“I agree to sell you 100 laptops at a price of \$500 per laptop on December 20th, 2020”.

That would be an example of a futures contract.

A futures agreement has four components:

- Type of good
- Quantity of good
- Date of transaction (contract expiration and delivery date)
- Price of good

In practice, the only variable we care about is price because it's the only thing that changes. The date of transaction, type of good, and quantity of good are all predetermined and standardized by the futures exchanges. For example, a WTI (West Texas Intermediate) oil contract always expires on the same day of every month. It also always represents 1000 barrels of oil.

The History Of Futures

Okay, so we understand what a futures contract is. But why were futures created? And how are they used?

Futures were originally created to help farmers hedge their exposure to price fluctuations. This practice helped them manage their businesses in volatile agricultural markets.

Say for example Farmer Steve grows corn. He plants his crop in March and harvests it in November. But Steve worries because he's not sure how much money he'll make from the harvest. It all depends on the going rate of corn at the end of the year. And that's tough to know so early on in March.

If the price of corn in November is going for \$4 a bushel, Steve will make a good amount of cash. Enough to cover his expenses, upgrade his processing equipment, and take a long vacation over the holidays.

At \$6 a bushel, Steve is the richest guy on the block. He can do all the above AND buy his wife the new Tesla she always wanted.

But at \$2 a bushel, Steve struggles to put food on the table and cover his farm and family's basic expenses.

Before the futures markets, Steve had to live with this uncertainty and just hope to have a good year. The price of corn at the time of harvest was out of his control. For all he knew, he could soon be living the high life, or struggling to cover his basic needs.

But luckily the futures exchange was created. Steve could now lock in the price he would receive for his corn crop months in advance. This eliminated the uncertainty of how much money he'd make by year end.

In March, well before the harvest, Steve could check the price of November corn futures. Let's say they were trading at \$3.75 a bushel. Steve would have the option to lock that price down right then and there. He could sell those November contracts to guarantee that price for his harvest.

After the sale, Steve would have an agreement with a counterparty to sell all his corn in November at \$3.75. Regardless if the price of corn in November is \$1 or \$10, Steve must sell his crop for \$3.75 a bushel.

Steve eliminates the risk and uncertainty of not being able to feed his family by taking this deal. Sure he won't be able to buy that Tesla, but Steve can settle for the guaranteed winter vacation. Not a bad choice. Plus he can now better manage his business and finances because he knows what price he will get in November.

You may be asking, if Steve is selling this futures contract, then who is buying it and why?

The buyer of Steve's futures contract is John. John owns a large soup company and corn is the main ingredient in his recipe.

The same price uncertainties that plague Steve, also plague John. If the price of corn is high in November, John will have to pay more to produce his soup. This will shrink his margins and his profits will take a hit. In this scenario, John may not have enough money left over to take his yearly golfing trip with the boys.

But if the price of corn in November is low, John will be rolling in dough. He'll be able to go on his trip AND put a down payment on a vacation home.

But like Steve, John would rather take certainty over a surprise feast or famine type scenario. He would be more than happy to buy all of Steve's corn at \$3.75 a bushel. This price would ensure that he could enjoy his golf vacation and feed the family.

Futures allow both business owners to reduce the volatility and uncertainty involved with their business, a win-win scenario for both sides!

Futures Price Mechanics

To recap, a future's contract is an agreement to transact at a specified date in the future. Each contract has a standardized term for the type of good, quantity of good, and delivery date of the good. Price is the only variable that changes which means it's the only variable we have to worry about as traders and investors.

But to understand how price changes, we first need to understand the quantity a futures contract represents.

When you buy stock, you buy it in individual shares. Say you buy one share of Apple. If Apple's stock price moves up by 1 cent, you earn 1 cent on your purchased share.

Say you buy 5 shares of Apple. If Apple's stock price moves up by 1 cent, you will gain 5 cents. You have 5 shares and each share appreciates by 1 cent. So your account rises by 5 cents. Pretty simple.

Futures are different. Take crude oil for example. There is no way to buy just one barrel of crude oil like you would buy just one share of a company. Futures trade in contracts.

These contracts are for large quantities of an underlying good. So for crude oil in particular, if you buy one contract, you are buying control over 1,000 barrels of oil. This means that when the price of a barrel of oil increases by 1 cent, the worth of your contract actually increases by \$10. Again, this is because you have control over 1,000 barrels ($$.01 \times 1,000 = \10).

The change in a price of a good has a multiplied effect on your account. This is because you hold a contract for multiples of that good. This is important to understand when evaluating the price movement of futures.

Most people are used to stocks. Stocks move in increments of 1 cent. The price of Apple stock can move from \$103.02 to \$103.03.

Futures don't operate this way. The underlying good of a futures contract moves in something called "ticks." A tick is the smallest amount the price of a good can move. This value could be \$.01 like stocks, but it could also be \$.10 or \$.25. Each type of future has a predetermined tick size set by the exchange.

You will also hear futures traders talk about "points." A point is just a \$1.00 move in the price of an underlying good.

For example, let's look at the predetermined parameters for a Crude Oil futures contract. The following table represents one Crude Oil contract. (Ticker: CL)

Underlying Quantity	1,000 barrels per contract
Tick Size	\$.01 per barrel (\$10 per contract)
Point Value	\$1.00 per barrel (\$1,000 per contract)
Expiration Schedule	Every Month

Using the table above, say the price of a barrel of oil is \$50.02. It then rises to \$50.82. This would represent an 80 tick move in the underlying good. Again, each tick in the underlying good is equal to \$10 in its companion futures contract ($$.01 \times 1000 \text{ barrels} = \10 per contract). So 80 ticks would mean an \$800 move in the futures contract ($80 \times \$10 = \800).

And if you had 2 crude oil futures contracts, you could expect your account to move by \$1,600 ($\$800 \times 2 = \1600).

As another example, here are the specifications for a gold contract. (Ticker: GC)

Underlying Quantity	100 fine troy ounces
Tick Size	.10 per troy ounce (\$10 per contract)
Point Value	\$1.00 per troy ounce (\$100 per contract)
Expiration Schedule	Feb. Apr. June. Aug. Oct. Dec. (every other month)

Every gold contract represents 100 fine troy ounces. Here the tick size is \$.10, not \$.01 like in oil. This means that the price of gold fluctuates by a minimum of 10 cents. Since a contract is worth 100 ounces, a \$.10 move in gold represents a \$10 fluctuation in a futures contract ($$.10 \times 100 = \10).

Per point or \$1.00 move, a gold contract changes in value by \$100 ($\$1.00 \times 100 \text{ ounces} = \100).

Each type of futures contract has different key values. Barchart.com has a great table listing all of them.

The link to the table is below:

<http://www.barchart.com/futures/specifications.php>

Futures Expiration

Futures use a standardized letter and number system to denote the expiration date of contracts. Letters refer to the month and numbers refer to the year.

For example, a crude oil contract expiring in Jan of 2016 will have the ticker symbol CLF6. CL is the commodity (crude oil), F is the month (January), and 6 represents the year (2016).

The table to the right lists the letters used for each month.

The contract closest to expiration is called the “active” or “front month” contract. This is the most liquid market where the majority of trading takes place. After the active contract expires, traders move to the next contract in the sequence.

But the active contract isn’t the only one traded. Hedgers will often transact in contracts much further in the future. They need this type of longer term planning to hedge their businesses. But in our case we trade for profit, not to hedge. So we almost always trade the front month or active contract.

What Happens At Expiration?

As speculators, we never want to deal with the official expiration of a futures contract. We have no interest in actually receiving or delivering the underlying commodity. Most of us have no way to store 1,000 barrels of oil or 5,000 bushels of corn anyway. So before a contract expires, we always close our position. After closing, we reevaluate, and may reinitiate our trade in the next

Month	Letter
January	F
February	G
March	H
April	J
May	K
June	M
July	N
August	Q
September	U
October	V
November	X
December	Z

closest expiring contract.

Investors who do hold a contract into expiration will have to fulfill its obligations. This means if you're short 1 contract of corn, you will have to deliver 5,000 bushels to the buyer. And if you're long 1 contract of corn, you will have to pay for 5,000 bushels and accept its delivery.

But don't worry about forgetting to close your position before expiration. Retail brokerages usually don't support delivery for their customers. They'll instead automatically close your positions before they expire. You will need to set up accounts at special brokerages if you want a dump truck of grain on your driveway.

Futures Margin - No Cash Exchanged

Remember, futures are an AGREEMENT to buy or sell something in the future. That's not the same as buying a stock or bond.

When you buy stock, your cash is exchanged for a company's shares. You own those shares and they're kept safe in your brokerage account. If you buy 100 shares of IBM at a price of \$100, your \$10,000 is exchanged for those 100 shares.

With futures, you're entering into a contract or "promise" to do something in the future. *No cash or goods are exchanged until contract expiration.* Instead, the broker requires you to put up some "good faith" collateral to ensure that you'll cover any losses that you may incur on the contract.

It typically costs around \$5,000 in collateral to hold a futures contract that represents \$50,000-\$100,000 worth of goods. That's a great deal. And it's why using futures is a capital efficient way to gain exposure to the markets.

Let's compare buying the SPY ETF to buying E-mini S&P futures (Ticker Symbol ES). Both instruments provide exposure to the top 500 U.S. companies.

Say SPY is trading at \$200. Purchasing 500 shares would cost you \$100,000. The total worth of the investment would be \$100,000.

The alternative would be purchasing 1 ES futures contract. 1 ES contract ends up being worth about 500 shares of SPY when it's trading at \$200. That makes the total investment equal to the same \$100,000 value as buying the ETF.

But here's the difference. The cost to buy and hold an ES contract is only \$5,750. So you get to control \$100,000 worth of S&P stock by only setting aside \$5,750. Compare that to the \$100,000 you need to fork over to control the same amount of capital with SPY.

The futures contract requires little capital to hold because it's just a contract. Nothing is transferred until expiration. You can just exchange your contract with someone else before that date. That's what the market is for! That way you don't have to hand over \$100,000 for that stock.

This example demonstrates the incredible capital efficiency of futures. It costs over 17 times more to hold SPY over ES, even though they control the same amount of exposure to the market!

Now think about the implications here. If the S&P increases by 1%, your holdings would increase by the same amount on both SPY and ES. But with SPY you would gain \$1,000 on the \$100,000 you put up. That's a gain of 1% on your capital. But with ES, you would gain \$1,000 on the \$5,750 you put up. That's a gain of over 17% on your capital! You're percentage gain on capital is 17 times better with futures than with just regular ETFs! That's why futures are such a powerful tool.

Futures Are Available For Everyone

Back in the day, futures were reserved for floor traders, banks, and commercial hedgers. But not anymore. Almost all futures markets have now converted from "open outcry" to electronic markets. It's no longer a bunch of pushy guys screaming at each other in the trading pits. Now computers automatically match buyers and sellers.

The advances in the futures market have made trading these derivatives easier than ever. Most popular retail brokerages allow investors to trade futures contracts. You can even go long and short futures in certain IRA accounts.

Below is a list of popular brokerages and whether or not they allow futures trading.

Interactive Brokers	Futures Trading Allowed
TD Ameritrade	Futures Trading Allowed
OptionsExpress by Schwab	Futures Trading Allowed
TradeStation	Futures Trading Allowed
E Trade	Futures Trading Allowed
Charles Schwab	No Futures Trading.
Fidelity	No Futures Trading.

At Macro Ops, we trade with Interactive Brokers. They have the best fee structure and the largest selection of futures products available. We recommend them for those looking to open a new brokerage account.

If you already have an account that allows futures, you just need to enable your trading access. The broker's website should have information on how to do this. If the website doesn't clearly explain the process, just contact customer service. Tell them you want to get your account permissioned for futures. They should be able to do it.

Once you're approved, you're good to go. Buying and selling futures on the computer is exactly the same as buying and selling stock. Just enter the appropriate ticker symbol and you're all set.

The Best Way To Start In Futures

As macro operators, we trade all markets and consider futures to be an integral part of our process. If we could only trade one thing, it would be futures. Their potential for massive returns makes them the best trading vehicle.

Elite members have real-time access to our model portfolios. In them, we show you exactly how to incorporate futures into a multi-asset portfolio of stocks, bonds, options, and more.

Whether it be through crude oil, cocoa, or soybeans, our goal with futures is to enhance yearly returns.

Together the Macro Ops team has traded well over \$100,000,000 worth of futures contracts. With this experience we've developed cutting edge processes to control risk and enhance returns.

Risk control is the most important part of any investing process. We work with members to make sure they understand this. We teach them how to size their positions and manage their own trades. This helps ensure they won't blow up their account. If you want to learn more about becoming a member, click [here](#).

If you have any questions, please do not hesitate to email us at:

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We would love to hear from you and answer any questions you have about futures.

Also, be on the lookout for our next futures special report which covers more advanced topics!