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EXCELLENCE THROUGH EXECUTION

HOW TO MAKE YOUR FIRST FUTURES TRADE

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How To Make Your First Futures Trade

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You have an opinion on the futures market, you want to get involved, but you don't know how or where to start. Sound familiar? If so, I have some good news for you. We are going to take on the goal of placing your first futures trade, a challenge that may seem to be a mountain, and make it into a molehill.

Let's say you think the grain markets are in a bull market, one that could last for months. Let's also assume you like the Corn market better than all the other grain markets. You think there is real potential in Corn because of the world wide demand for food, the ethanol mandate that requires using corn for energy, and expected inflation in food prices because of a weaker US Dollar. Not only do you like the fundamentals, but you also like the technical trend.

You look at the charts and it is in a bullish up trend. All the moving averages are trending up, and your momentum indicators are all bullish. The example I am using is for the Corn market, but you could have a bullish or bearish opinion in Crude Oil, Gold, US 10 Year Note, S&P 500, Soybeans, Cattle, Sugar, the US Dollar or any other futures market for that matter. You can use the following exercise as a guide to make your first trade in any commodity futures market.

Know Your Futures Contract Tick Values

A futures contract of Corn is worth 5,000 bushels. Let's say Corn is trading at \$6.00/bushel and moves up 1 cent to \$6.01/bushel. Corn went up 1 cent, but it went up 1 cent for 5,000 bushels in the futures contract. The 1 cent gain needs to be multiplied by 5000 bushels.

$$\begin{aligned} \$0.01 \times 5000 \text{ bushels} &= \$50.00 \\ 1 \text{ cent in Corn equals } &\$50 \end{aligned}$$

So the next time you see on CNBC, Bloomberg, the Wall Street Journal, or any other financial news organization that corn is up 7 cents for the day, you will know to multiply it by \$50 to get the monetary move in the standard futures contract.

$$7 \text{ cents} \times \$50/\text{cent} = \$350 \text{ per contract.}$$

You should also know that some markets have mini contracts. The Mini Corn contract is for 1000 bushels, which is 1/5th of the size of the standard 5000 bushel contract. When you are trading mini corn and it moves 1 cent, the multiplier is 1000 bushels.

$$\begin{aligned} \$0.01 \times 1000 \text{ bushels} &= \$10.00 \\ 1 \text{ cent in mini corn equals } &\$10 \end{aligned}$$

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The next time you see that corn was up 7 cents for the day, you now know that is up \$70 in the mini contract (7 cents X \$10) and \$350 in the standard contract (7 cent X \$50).

Now that you know your futures contract tick values for Corn and how to turn them into real dollar amounts, you can figure out the tick values for all commodity futures. The only additional tool you will need is our **dt Futures Calculator**:

<http://www.danielstrading.com/resources/futures-calculator/>



Calculating tick values do not have to be scary or difficult. Once you know the numbers, it is a matter of simple math that a fifth grader could do (are you smarter than a 5th grader?).

Know Your Total Futures Contract Value

Now that you know the dollar amount for price changes, the next thing you need to know is what these futures contracts are worth as a whole. In order to figure that out, we need to know the total value of the futures contract.

Corn is trading at \$6.00/bushel. A contract of Corn is for 5000 bushels. To find the total contract value, we need to multiply the price per bushel by the number of bushels in the contract. In this case we need to multiply price (\$6.00/bushel) by the contract multiple (5000 bushels of corn)

$$\text{\$6.00 X 5000 bushels} = \text{\$30,000}$$

That means one standard contract of Corn trading at \$6.00 is a \$30,000 futures contract. The mini contract is only 1000 bushels of Corn. So if Corn is trading at \$6.00 a bushel, we only have to multiply by 1000 bushels to get the total contract value for Mini Corn.

$$\text{\$6.00 X 1000 bushels} = \text{\$6,000}$$

Does this mean you need \$6,000 in your account to trade a Mini Corn, or \$30,000 to trade standard futures contract? Absolutely not. Commodity futures are traded on margin, where you only need a percentage of the total contract value to hold a position. We will dive into this further in the next section.

How To Make Your First Futures Trade

Now that you know how to find the total contract value of Corn, you can figure out the total contract value for all commodity futures. All you need to know is the price and size of each contract, which can be found in our **dt Contract Specifications**:

<http://www.danielstrading.com/resources/reference/contracts.php>

Total Contract Value = Market Price X Contract Size



Mountain to Molehill Summary

Total Contract Value = Market Price x Contract Size. You may need a calculator for some of the contracts, but it is still simple mathematics!

Know Your Futures Margins

Margin is the minimum amount of available funds you need in your account to hold a futures position. Each market will have a different margin requirement. Margins are determined by the exchanges. The margin for the standard 5000 bushel Corn contract is \$2025 and the margin for 1000 bushel Mini Corn is \$405. Mini Corn is a fifth of the size of the standard Corn contract, so therefore the margin is a fifth of the size also. That means if you want to enter into a Corn position you have to have at least \$2025 in available funds for the standard 5000 bushel contract, or \$405 for the 1000 bushel Mini Corn.

Margin is not the recommended amount of capital you need for a position. Margin is just the minimum amount of capital the exchange and clearing firms want traders to have in their accounts. There are two types of margin. The first is Initial Margin. Initial Margin is the amount of capital you have to have in your account before you entered into a position. The Initial Margin for Corn is \$2025 and for Mini Corn is it \$405.

Maintenance Margin the second type of margin. This is the amount of liquid funds you need in your account to maintain and hold a position. Maintenance Margin is \$1500 for Corn and \$300 for Mini Corn. If you fall below the Maintenance Margins levels, your broker will notify you that you need to either close your position or send in additional funds.

How To Make Your First Futures Trade

For a list of margins for you can go directly to the exchange and search for their “performance bond” or “margin” listing, or you can go to the **dt Margin Page**:

<http://www.danielstrading.com/resources/reference/margins/>



Mountain to Molehill Summary

Margin is nothing to be afraid of. As long as you know the margins for the contracts you are trading, you will know the minimum amount of capital you need to control any futures contract, subject to any losses if the contract moves against you.

Know Your Leverage

Leverage and margin are similar but separate subjects. Margin is the minimum amount of capital you need to hold a position. Leverage is the ability to use a specific amount of capital in order to control a much larger asset in terms of valuation.

The most prominent example for the use of leverage is when a person buys a house; they are using leverage by taking out a mortgage. Let's say you want to buy a house and the price is \$200,000. The bank wants you to put down 10%, which is \$20,000. The other 90%, or \$180,000, is mortgaged. The note covers the first \$180,000 of the house and the home owner has equity of \$20,000.

As the price of the house increases, the gains made go to the home owner. If the house increases in value by 10% (\$20,000) to \$220,000, the mortgage is still \$180,000, but the homeowner's equity is now \$40,000. The homeowner has a 100% return on his investment and the price of the house only had to go up 10%.

Leverage can be a double edged sword. Let's say the price of the home decreases by 5%, or \$10,000. That means the price of the home is only worth \$190,000. The mortgage is still \$180,000. However, the home owner's equity is now \$10,000, down from \$20,000, which is a decrease by 50%. The price of the home only had to decrease by 5% for the home owner to have a loss of 50% in their equity.

You can take the same concept of leverage with respect to buying real estate and apply it to trading futures. Let's say you have a \$10,000 futures account. You are long corn at \$6.00/bushel. The total contract value is \$6 X 5000 bushels = \$30,000.

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If corn goes up 20 cents from \$6.00 to \$6.20 per bushel, the trader is up \$0.20 in corn, or \$1000 (\$0.20 X 5000 bushels). The price of corn went up about 3% but the trader's equity increased 10% (from \$10,000 to \$11,000). If corn goes down ten cents (\$0.10) from \$6.00 to \$5.90 per bushel, the trader is down \$0.10 in corn, or \$500. While the price of corn is down almost 2%, the trader's equity is down 5% percent (from \$10,000 to \$9,500).

Just like how a homeowner can choose their leverage by using a 5%, 10%, 20% or even 50% down payment on a home, so too can the futures trader. A futures trader with a \$10,000 account can be long 1 futures contract, controlling \$30,000 of Corn, they can be long 2 futures contracts, controlling \$60,000 of Corn, and to use a very aggressive example, they could even be long 4 contracts of Corn controlling \$120,000 worth of Corn (4 contracts X \$2025 margin = \$8100 of required margin for the sample \$10,000 account).

A more conservative trader with a \$10,000 account may choose to own a mini contract, which has a total contract value of only \$6,000 (\$6.00/bushel X 1000 bushels). In this case the trader is not leveraged at all since he has enough available cash to cover the full value of the contract. I have seen many traders with \$10,000 accounts choose to trade a 2 or 3 lot of Mini Corn instead of one of the standard contracts. The smaller contracts give them more flexibility of when to scale in and out of positions. They also give the trader more control over the leverage they are using.

Now that you know how to determine the leverage you are using for Corn, you can determine the leverage you are using for any futures contract. All you have to do is determine the Total Contract Value and then divide it by your Account Liquidation Value. This is what I like to call the Account Leverage Ratio, which we go into greater detail below.

Account Leverage Ratio = Total Contract Value / Account Liquidation Value



Mountain to Molehill Summary

For many people, leverage is part of every day life. If you own a home, chances are you are already using leverage, especially if you have a mortgage. Leverage in the futures market is the same concept. If you understand how the real estate market works when it comes to down payments and mortgages, you will understand how margin requirements and leverage work in the futures markets.

THE RISK OF LOSS IN TRADING COMMODITY FUTURES AND OPTIONS CONTRACTS CAN BE SUBSTANTIAL. THERE IS A HIGH DEGREE OF LEVERAGE IN FUTURES TRADING BECAUSE OF THE SMALL MARGIN REQUIREMENTS. THIS LEVERAGE CAN WORK AGAINST YOU AS WELL AS FOR YOU AND CAN LEAD TO LARGE LOSSES AS WELL AS LARGE GAINS.

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Know Your Account Leverage Ratio

Your Account Leverage Ratio is a simple calculation that lets you know how much leverage you are using in your account. All you need to know is the Total Contract Value of all of your positions and divide it by the Account Net Liquidation Value

$$\text{Account Leverage Ratio} = \text{Total Contract Value} / \text{Net Liquidation Value}$$

For example, let's say we are long Corn at \$6.00 with a \$10,000 account. The total contract value is \$6.00/bushel X 5000 bushels = \$30,000. The Net Liquidation Value of the account is \$10,000. My Account Leverage Ratio is \$30,000/\$10,000, or 3:1. If I was long 2 Corn contracts with a \$10,000 account, my account leverage ration is \$60,000/\$10,000, or 6:1. If I really wanted to leverage up in Corn, I could be long 4 contracts of corn, controlling \$120,000 worth of corn with a \$10,000 account. My Account Leverage Ratio would be \$120,000/\$10,000, or 12:1.

Leverage Guidelines for Futures Trading

Below are some leverage guidelines based on your own risk tolerance:

Less Risk: up to 5:1 leverage

More Risk: up to 10:1 leverage

Greater Risk: over 10:1 leverage

Once you get over 10:1, you have less room for error. A big move in the market can lead to a very large gain or loss, depending on what side of the market you are on. The more leverage you are using, the more potential you have to gain, but also note your account is taking on more risk. The challenge for the trader is to find how much leverage is optimal for his or her account. If you are unsure of how much leverage you should be using, I suggest no more than 5:1. When starting off, less leverage is best. When you get more confident trading the markets and more comfortable with leverage, then you can decide for yourself if increasing your Account Leverage Ratio past 5:1 is appropriate for your trading.



Mountain to Molehill Summary

Knowing the exact amount of leverage you are using in your account is a simple mathematical formula. Just plug and chug, and you'll know exactly how much leverage you are using.

$$\text{Account Leverage Ratio} = \text{Total Contract Value} / \text{Net Liquidation Value}$$

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Know Your Risk and Reward

Last, but not least, traders need to know the risk and reward for their trades. Traders should know their risk and profit strategies before they enter the trade, and then stick with it until the trade ends. If you are long Corn at \$6.00, the first thing you need to do is either come up with a monetary risk loss (say \$500) or you look on the chart for natural support levels. If you want to attempt to limit your risk to only \$500, then that is 10 cents in the Corn contract (\$500 divided by \$50 per 1 cent in corn is 10 cents). A move from \$6.00 down 10 cents to \$5.90 represents \$500 in Corn. A trader would be long at \$6.00 and have a sell stop at \$5.90.

Another way to set a stop is looking at support levels. Let's say you look at the chart and see that the last 3 times Corn has traded to \$5.80, the market stabilizes and then goes back up. That is strong support for Corn. The trader would put his stop a few cents below \$5.80, the natural support point. If the trader decided to have the stop at \$5.75, he is risking 25 cents ($\$6.00 - \$5.75 = \$0.25$) or \$1250 (25 cents X \$50/cent = \$1250).

As you can see, all of these calculations are simple math. As long as you know the tick values and the prices that the market is trading at, you can figure out potential losses and gains in a matter of seconds.

If the trader thinks these stop loss amounts are too much money, he can always trade Mini Corn, which is a fifth of the size of the standard Corn contract. A ten cent stop loss in Mini Corn is only \$100. Risking 25 cents from \$6.00 to \$5.75 is only \$250. If the trader wanted to risk \$500 on the trade, he could get long two Mini Corn contracts instead of one.

As soon as the trader has the risk set, he then needs to have a profit taking strategy. There are many ways to do this, but for now we will go over the most popular. The first is solely based on a monetary objective. If the trader wants to make \$1000 in Corn and he is long from \$6.00, he will use a limit order to sell at \$6.20. Buying at \$6.00 and selling at \$6.20 is a 20 cent gain in Corn, or \$1000 (20 cents X \$50/cent = \$1000)

The second option the trader has is to look at the chart and find natural resistance levels. The trader may look at the chart and notice that every time Corn has reach \$6.50, the contract has sold off as the market takes profits. The trader can place a sell order at \$6.50. If the market reaches those resistance levels again, he will attempt to exit the position at \$6.50. That would be a 50 cent gain from \$6.00 to \$6.50, or a gain of \$2500 ($\$50 \times 50 \text{ cents} = \2500)

STOP LOSS ORDERS DO NOT NECESSARILY LIMIT YOU LOSS TO THE STOP PRICE BECAUSE STOP ORDERS, IF THE PRICE IS HIT, BECOME MARKET ORDERS AND, DEPENDING ON MARKET CONDITIONS, THE ACTUAL FILL PRICE CAN BE DIFFERENT FROM THE STOP PRICE. IF A MARKET REACHED ITS DAILY PRICE FLUCTUATION LIMIT, A "LIMIT MOVE", IT MAY BE IMPOSSIBLE TO EXECUTE A STOP LOSS ORDER.

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The last method is to not have a set profit target, but to trail your stop as the price of Corn moves in your favor. Let's say you are long Corn at \$6.00 and the stop is \$5.75. The stop is 25 cents behind your entry point. The next day Corn has moved from \$6.00 to \$6.10. The trader then moves his stop 10 cents, from \$5.75 to \$5.85. The amount of risk that he is attempting to limit has just been reduced \$500 from \$1250 to \$750. As Corn goes higher, the trader continues to move the stop.

This method allows the trader to stay in the trade as long as the momentum is with Corn and the market continues to trade higher. When the momentum finally subsides, the trader's position will eventually be stopped out. If Corn continually trades higher to \$6.50 without ever pulling back by 25 cents or more, that could represent a \$2500 gain (50 cents X \$50 = \$2500). However, we could also only trade as high at \$6.10 and then come back down to \$5.85, and it would represent a \$750 loss (\$6.00 - \$5.85 = \$0.15, which is -\$750).

Now that you know how to determine risk and reward, you will be able to effectively set stops and targets, which are so vital in a trading plan. As long as you have a chart of the market you are trading, you should be able to find natural levels of support and resistance in the markets. If you do not already have access to futures quotes and chart, you may find them here in **dt Quotes & Charts**:

<http://www.danielstrading.com/resources/quotes-and-charts/>



Mountain to Molehill Summary

Mountain to Molehill Summary: There are three types of trading plans most traders use for profit and loss parameters. All you need to do is pick a method you are most comfortable with:

1. Monetary Stops and Targets
2. Technical Support & Resistance Stops and Target
3. Trailing Stops

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Putting It All Together

So let's review how we've made this mountain a molehill and go over what we have covered. You now know your tick values, total contract value, margin, leverage, account leverage ratio, and how to determine the risk and reward of your trades. If you have an opinion about a commodity futures market, you have the ability to trade that idea. Your trading idea on the market could be based on the fundamentals, technical analysis, or a combination of both. Regardless of how you derived your analysis of the market, you now possess all the relevant information you need to make your first futures trade.

If you are new to the markets and still uneasy on how to take the first step, now is the time to work with your Daniels Trading broker and do some paper trading. We will work with you and make sure you are comfortable with how to trade futures contracts. When you've reached this point, we will know when you are ready to trade in a real, live futures account.

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If you enjoyed the this article, the educational nature, and the way it was presented, then I highly recommend you sign up for a free subscription to my weekly newsletter, Turner's Take:

<http://www.danielstrading.com/offers/398/178/>

About Turner's Take

Turner's Take is a weekly market commentary newsletter with intraday trade recommendations published by Craig Turner, Senior Broker with Daniels Trading in Chicago. Turner's Take was created to give traders and investors a window into the elusive world of LaSalle and Wall Street.

BEING A SUCCESSFUL PAPER TRADER DURING ONE TIME PERIOD DOES NOT MEAN THAT YOU WILL MAKE MONEY WHEN YOU ACTUALLY INVEST DURING A LATER TIME PERIOD. MARKET CONDITIONS CONSTANTLY CHANGE.

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About Craig Turner

Craig Turner is a Senior Broker at Daniels Trading and the author of the Turner's Take futures and options newsletter.

Craig began his career in the Financial Industry in 1998 providing trading support at the NYSE and then moved on to Goldman Sachs as a Technical Analyst in 2000, focusing on Commodity and Futures trading systems. Craig joined Daniels Trading in Chicago in 2007 as a Futures & Options Broker. He has his bachelors from the Rensselaer Polytechnic Institute (RPI) and his MBA from Stern School of Business at New York University (NYU), which was part of the Goldman Sachs Executive Program.

Craig uses his understanding of Fundamental and Technical Analysis to help traders identify and act on trading opportunities in the Futures & Options markets. Craig has a deep and extensive knowledge of Online Trading Platforms, Pit Execution, Option Strategies, Systems Trading, Newsletter Trading, and Managed Futures. Craig excels in providing exceptional client service, trading execution, and the ability to expertly match client assets with trading and investment opportunities.

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