Zuger Kantonalbank

Traded options and financial futures (TOFF)

Asset class fact sheet

This document informs you about the characteristics, advantages and risks of traded options and futures (hereinafter traded derivatives) and is designed to help you make your investment decisions. If you have any further questions, please do not hesitate to contact your client adviser at any time.

Traded options and financial futures are standardised future transactions between two parties.

- In the case of options, you, the buyer, acquire the right to buy (call option) or sell (put option) a specific quantity of a specific underlying asset (stock, bond, commodity, etc.) on or by a defined date at an agreed price.
- Futures are standardised traded future transactions where two contracting parties undertake to buy or sell a specific underlying asset on a date and at a price defined in advance. Futures are traded on the stock market and can be bought and sold during their term.

Exercise opportunities

With options, when it comes to exercise opportunities, a distinction is drawn between a so-called American and European type. In the case of American-type options, the right can be exercised during the term, while in the case of the European-type; this is possible only at the end of the term.

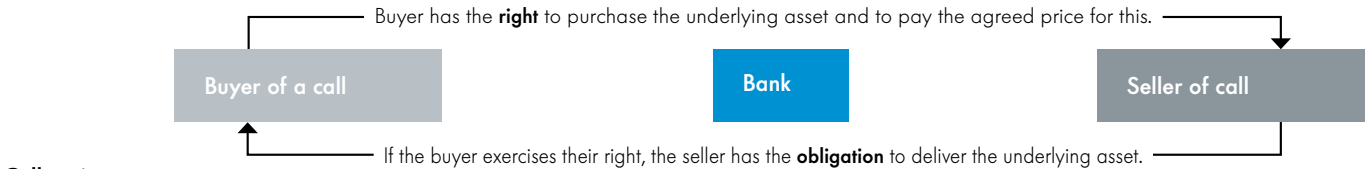
Price determination

- The theoretical price of an option is dependent upon many factors: e.g. current price and volatility of the underlying asset, residual term or dividend payments during the term. The market price of an option also depends on the bid/ask spread, supply and demand, as well as liquidity.
- The theoretical price of a future is dependent upon the current price of the underlying asset and holding costs (cost of carry). The market price of a future is also dependent upon supply and demand, as well as the liquidity of the underlying asset.

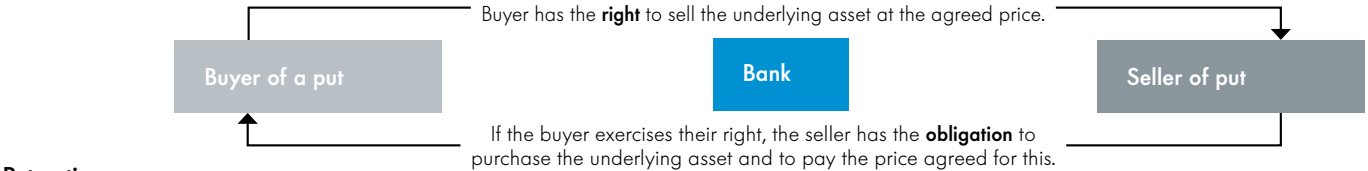
Collateral

Options: Options are also subject to a substantial risk if these are short sold (cover requirements).

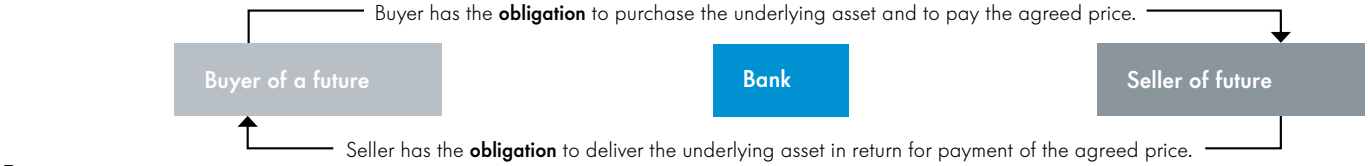
Futures: Trading in futures entails substantial risks, since the underlying still has to be delivered (or accepted) at the price agreed initially even if the actual price of the underlying has risen above/fallen below this agreed price in the meantime. For this reason, collateral must be deposited in the form of cash, securities or a bank guarantee. This collateral is known as the initial margin and is mostly expressed as a percentage of the value of the future. The collateral is checked on a daily basis. If it is not sufficient, the client shall be obliged, at the request of Zuger Kantonalbank, to pay in additional cash or to provide additional collateral (margin call). If no further collateral can be provided, the futures contract or option will be closed out and sold with a loss for the investor.



Call option



Put option



Future

Wir begleiten Sie im Leben.

Benefits

Standardised derivative products

Traded derivatives are standardised contracts with fixed terms and strike prices that can be traded on a daily basis on stock markets. The contractual conditions cannot be individually structured. Traded derivatives are traded as a multiple of the underlying asset per contract. The multiplier defines the size of the contract.

Investment with low capital deployment and leverage

When buying an option, the investor pays an option price (or option premium). The option premium is much smaller than the value of the underlying asset. When concluding a futures contract, the investor does not incur any costs in the form of premiums. Nevertheless, an advance payment in the form of the initial margin must be provided. This makes it possible to participate in the performance of the underlying asset, even with a low capital deployment. The low capital deployment creates the so-called leverage effect. The result is that investors participate disproportionately in the price gains as well as in the price falls of an underlying asset.

Profit from falling prices

Traded derivatives enable investors to profit not merely from rising prices, but also from falling prices. This can be done by acquiring put options in the expectation of sinking underlying asset prices, or by selling call options in the expectation of rising underlying asset prices.

Hedging

Traded options and futures can be deployed as a hedge against undesired price developments. Individual items or the entire portfolio can be hedged.

Risks

Market risk

The option or future price can move against the investor. Option prices can be influenced by the current price of the underlying asset, the strike price, the residual term, the volatility of the underlying asset, interest rates and dividends during the term.

The market risk for futures is directly dependent upon the price model of the respective future, the liquidity, as well as the price of the underlying asset.

Liquidity risk

The liquidity of a traded derivative describes the opportunity for the investor to buy or sell their derivative daily at market prices. The investor bears the risk that they may not be able to sell the derivative at any time or at reasonable market prices.

Foreign exchange risk

The investor may be exposed to a foreign exchange risk if underlying assets are traded in a currency that differs from the derivative or if the derivative is denominated in a currency other than the domestic currency of the investor.

Underlying asset risk

The investor bears the risk that the value of the derivative could decline on account of price changes or changes in the volatility of the underlying asset. In the event of falls in value, the leverage effect means that changes in the price of the underlying asset can be many times higher than the change in the value of the underlying asset. Changes in the volatility of the underlying asset can also reduce the value of the derivative if the price of the underlying asset remains constant.

Execution risk

If a physical delivery was agreed at the time of the conclusion of the derivative, it could be very expensive or even impossible to acquire the underlying asset. In the case of American options, the investor bears the risk that the exercise of the option could take place at a time that is unfavourable. Furthermore, there is a risk that the option price could change while the option is being exercised, to the detriment of the investor.

Leverage risk

Options and futures respond disproportionately to rises or falls in the price of the underlying asset. This means they entail higher loss risks. The larger the leverage, the more risky they are.