

'Closing Out' Futures Contracts

A trader closes out their position by making the opposite trade to what that they did before.

For example, a trader who originally bought 3 futures on live cattle maturing in December may later decide to close out her position by shorting 3 live cattle futures that mature on the same date on the same exchange.

Closing out is useful for avoiding futures contracts' physical delivery of, for example, thousands of tons of live cattle when you work in an office building. Instead of having to train to become a cowboy, you can just close out the futures contract before maturity, avoiding physical delivery. Closing out futures is also useful to achieve specific non-standard maturity dates.

Closing Out Futures to Replicate Specific Maturity Dates

Closing out futures is very useful when you wish your futures contract matured before the standardized maturity dates specified in the futures contract.

To achieve a specific maturity or expiry date, just close out your futures on whatever date you prefer.

The only problems with this strategy are:

- Liquidity risk: will there be a counterparty to trade with when you want to close out, and how much will it cost?
- Basis risk: will the futures price quote be the same as the underlying asset price when you close out?

Trading Volume

Trading volume per day is usually measured in contracts per day, it is the number of long contracts traded. Of course this will also equal the number of short contracts traded too.

Trading volume is a 'flow', not a 'stock'. It has a time dimension, so it's measured in volume per time period. Usually contracts per day.

Open Interest

Futures contract open interest is the sum of net long positions across all traders.

This is equal to the sum of all long positions entered into (trading volume) since the contract first appeared, less the sum of all long positions closed out.

Open interest is a 'stock', not a flow. Open interest is 'as at' a point in time, rather than over a period of time.

Changes in Volume and Open Interest

A single futures trade will always increase trading volume by one. But open interest will either:

- increase by one if both long and short traders are entering into new positions;
- stay the same if the long trader is closing out his previously short position and the short trader is entering into a new position, or vice versa;
- decrease by one if both the long and short traders are closing out their previously short and long positions respectively.