



## TenStep Supplemental Paper

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12 May 2008

### Forward Contract

**Definition:** A forward contract is an agreement between two parties for the purchase and sale of a commodity or financial asset at a specified price to be delivered at a specified future date.

#### Forward Transactions

A forward involves no fees, and no cash changes hands until the settlement date of the forward. A forward allows you to lock in an exchange rate today for a future payment or receipt, thereby eliminating exchange rate risk.

Forward contracts are tailor-made to meet the needs of the parties involved. In the case of banks, financial assets are protected, and in the case of traders, commodities are protected. Forward markets have flourished as a means to reduce price uncertainty.

#### Advantages:

The benefits of a forward contract are:

- It can be used to hedge or protect a party from the price fluctuations to the extent of 100%.
- The upfront fees or margins are not applicable to forward contracts, so there are no initial costs.

#### Disadvantages:

- Forward contracts are not performance guaranteed, so they involve counter-party risk.
- The investor cannot derive any gain from favorable price movements either before or on the delivery date.
- Forward contracts are not traded in the secondary market, so there is no ready liquidity.
- Banks enter into reverse transactions to square positions, so they charge a huge bid-ask spread.