

Futures Markets

“FARM” Marketing 101 - Dairy

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Overview

- New Language
- Examples



Futures and Options

- It's Like a Whole Other Language
 - In some ways it is
- Language is the Hard Part
 - Language, code, gibberish
- Remember: Futures Market is Just Paper – It's a Contract to Buy or Sell in the Future

Bears and Bulls

- This One is Easy
- Bears – Price is Going Down
- Bulls – Price is Going Up

Longs

- Long is to Own the Commodity or the contract
- To Be “Long” is to Have Bought a Futures Contract
- Producers may be Thought of as “Long” Because They are Producing the Product
- Expect the Price to Increase

Shorts

- To Sell The Commodity or Futures Contract
- “Don’t Sell Me Short”
- Expect the Price to Fall
- Recent Example: Shorting Stocks

Hedgers

- Taking Positions in Market to Manage Price or Risk on Products That They Produce or Have to Buy to Use
- Farmers, Feedlots, Flour Mills, Cheese Makers, Meat Packers, Southwest Airlines

Speculators

- Those Taking Positions Who Do Not Have the Physical Commodity or Do Not Purchase it For Use
- Individuals, Funds, Others
- People Who Hedge May Also Have a Speculative Position
 - Larger futures position than actual production

Commercial and Non-Commercial

- Commercials are those who take positions but also use commodity
 - Elevator, farmer, etc
- Non-Commercials are those who don't use the commodity
 - Speculators
- Related to Trading Rules and Reporting
 - Reports on positions of comm. and non-comm. Traders
- 9 – Used to be more rules, not sure what is followed

Basis

- Cash Price Minus Futures Price
- Cash Price at Your Location or Where You Sell
- Can Be a Large Source of Risk
- Varies By: Distance, Time, Quality
 - Central Texas corn example
 - Increasing gas prices

Example 1

- Dairy Farmer – Sell Futures (Short)

Sell Mar 09 Contract 10/20/09	\$14.68
Buy Mar 09 Contract 3/9/10	\$14.00
Net	\$0.68
Class III Milk Price	\$14.00
Net III Total Positions	\$14.68
Milk Check	\$16.00
Net	\$16.68
₁₁ Basis ? This Example	\$2.00

Example 2

- Corn Farmer – Sell Futures (Short)

Sell Dec 10 Contract 10/20/09 \$4.25

Buy Dec 09 Contract 11/9/10 \$5.00

Net -\$0.75

Cash Market Sell Corn \$5.25

Net Total Positions \$4.50

Basis ? This Example \$0.25

Example (Cont.)

- Milk Producer – Sell Futures (Short)
- But, Milk Down Limit on 12/12/09
- No Action on Contract, But, Gain in Value of Position
 - Gain * # of cwt contracted on futures
 - If it goes the other way, then margin calls must be met.
 - But, probably do this through co-op so understand the contract.

Other Stuff

- Need to Find a Broker
 - Ask around, find someone with good reputation and one you are comfortable with
- Open Account
 - Be prepared for margin money
- Work With Your Banker Too
 - Part of marketing plan and budget
- Keep It Simple
 - Can get too complex

More Stuff

- The Futures Position Locks in a Price
 - Limits upside potential
- Basis Risk Exists
 - Can fluctuate a lot
- What About Calves? Or Other Feed
 - Only a feeder cattle contract
 - No forage contracts
 - “cross hedging”