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Market Journal Toolbox

Becky Small

University of Nebraska-Lincoln

Darrell R. Mark

University of Nebraska-Lincoln, dmark2@unl.edu

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CORNHUSKER ECONOMICS

Market Journal Toolbox

Market Report	Yr Ago	4 Wks Ago	10/27/06
<u>Livestock and Products,</u>			
<u>Weekly Average</u>			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight	\$87.22	\$90.83	\$89.16
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb	132.15	128.57	116.85
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb	122.00	117.10	108.79
Choice Boxed Beef, 600-750 lb. Carcass	145.66	141.34	147.66
Western Corn Belt Base Hog Price Carcass, Negotiated	57.94	61.25	61.09
Feeder Pigs, National Direct 45 lbs, FOB	53.60	52.76	54.01
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean	64.10	67.17	66.45
Slaughter Lambs, Ch. & Pr., 90-160 lbs., Shorn, Midwest	92.00	99.62	*
National Carcass Lamb Cutout, FOB	245.01	245.47	250.77
<u>Crops,</u>			
<u>Daily Spot Prices</u>			
Wheat, No. 1, H.W. Imperial, bu	*	4.46	4.84
Corn, No. 2, Yellow Omaha, bu	1.48	2.38	3.07
Soybeans, No. 1, Yellow Omaha, bu	5.17	4.92	6.14
Grain Sorghum, No. 2, Yellow Columbus, cwt	2.29	3.68	4.91
Oats, No. 2, Heavy Minneapolis, MN , bu	1.83	2.25	2.53
<u>Hay</u>			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton	117.50	135.00	135.00
Alfalfa, Large Rounds, Good Platte Valley, ton	37.50	87.50	87.50
Grass Hay, Large Rounds, Good Northeast Nebraska, ton	52.50	82.50	82.50
* No market.			

Producers often rely on cash market sales without the use of forward contracting, futures hedging and other risk management tools for several reasons. Some producers perceive that the use of hedging lowers their net price or increases price variability on average. Others view hedging as a risky price enhancement mechanism that is reliant on being able to successfully forecast futures prices. Selling crops or livestock that have not yet been raised, paying margin calls and dealing with brokers are all viewed as risk-inducing activities for some farmers and ranchers. Many producers indicate their use of forward contracting and hedging is limited most by their understanding of the market institutions, contracts and logistics of these risk management techniques.

Interestingly, Schroeder et al. found that over 70 percent of producers attending an extension conference cited risk reduction as their primary marketing goal. However, less than 20 percent of those same producers used forward contracts, futures hedging or options hedging to lower their risk. Significant economic literature exists that shows practices like futures hedging reduce variability of prices (Berck; Bond and Thompson; Kahl; McKinnon; Schroeder and Hayenga; Zulauf et al.). These studies also confirmed the traditionally expected negative correlation between risk and return, citing that on average, hedging also results in lower prices. Perhaps producers inherently know this and historically have been willing to take on price risk by not hedging in order to receive higher returns. However, there are several reasons why producers may seek to lower their price risk exposure at the expense of returns in the future, and therefore need additional understanding of how to apply risk management practices to their operation.

One consideration producers need to keep in mind when deciding whether or not they will manage price risk is the variability experienced in the market in recent years. Variability in agricultural commodity prices is reflected in recent changes in the futures market. Daily price limits have been expanded in recent years. For example, the daily price

limit on corn and soybeans was raised from \$0.12/bu and \$0.30/bu to \$0.20/bu and \$0.50/bu, respectively. The price limit on live cattle and feeder cattle futures contracts increased from \$1.50/cwt to \$3.00/cwt. These changes were made in an effort to allow the market to fluctuate enough for hedgers and speculators to enter and exit the market in fast moving markets. Similarly, the number of contracts a single trader is allowed to have in the futures market has increased substantially to enable traders to lay off or accept (as hedgers and speculators, respectively) more risk in the futures market. For example, the position limit for a trader in the corn and soybean futures market has increased by 266 percent and 133 percent from 1994 to 2006.

One result of these changes to the futures market has been increased investment interest from nontraditional sources. Mainly these are index fund traders investing retirement account dollars in indexes like the Goldman Sachs Index Fund. These types of funds then trade a mixed portfolio of futures contracts, including agricultural commodity futures. Index funds are often intended to be used as a hedge against inflation; therefore, index funds typically take a long position in the futures market. Given the substantial increases in index fund investment in agricultural and energy markets over the past couple of years, this substantial amount of buying has the effect of raising prices – at least for a period of time. Because futures contracts expire, eventually index funds will roll out of an expiring futures contract and into a more deferred contract. This rolling period can result in selling pressure driving down prices in the nearby contract, and buying support in the deferred contract. Because of their potentially large moves, the index funds appear to have introduced additional volatility into the market. While the additional variability can provide good pricing opportunities for farmers and ranchers, it underscores the importance of additional risk management.

Because of these issues, it is important for producers to learn to use basic risk management and marketing techniques and routinely apply them on their operations. More importantly, the introduction of newer risk management products (e.g., insurance contracts, new generation cash grain contracts) offer innovative solutions to producers' emerging risk management needs. Further, understanding how to combine the myriad of risk management tools now available is increasingly important and can even offer some strategies, where the traditional risk-return tradeoff decision is not quite so difficult to make.

To meet producer needs for marketing and risk management education, the University of Nebraska–Lincoln Extension, the Department of Agricultural Economics and the Department of Communications and Information Technology developed Market Journal Toolbox. As a new marketing and risk management extended education program, Market Journal Toolbox is a “take-home” companion to the weekly Market Journal program.

Market Journal Toolbox is comprised of 16 classes taught by UNL educators covering a variety of marketing and risk management tools. Topics discussed include basis trends, seasonality, cash contracting, futures and options hedging, insurance products, government farm programs, new generation contracts and much more. This educational program is unique in that it explicitly identifies which risks each tool manages and how the tools can be used together. Market Journal Toolbox viewers then develop a comprehensive marketing plan based on the need for minimizing production, price and basis risks.

Market Journal Toolbox is a five DVD package with a bonus resource CD. The resource CD contains the PowerPoint slides for each section, a short summary of each section and a glossary of marketing and risk management terms. The CD also includes a tool selector, which assists producers in selecting the necessary combinations of tools to fit the needs of their operation, and a user's survey that allows them to determine and rate their understanding of the material presented in each section.

Market Journal Toolbox was partially funded by a grant from the North Central Risk Management Education Center. To order, or learn more about Market Journal Toolbox, go online at marketjournal.unl.edu.

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Becky Small
Market Journal Toolbox Host

Darrell R. Mark, (402) 472-1796
Extension Livestock Marketing Specialist
University of Nebraska–Lincoln
dmark2@unl.edu