• Commodity

(Continued from Page 1)

Hedging

Hedging is a protective procedure designed to minimize the farmer's production losses that are due to adverse price fluctuations During the various stages of the ordinary growing or fattening period someone must assume the possibility of loss that unavoidably accompanies the ownership of the physical commodity This possibility is ever present as long as the farmer owns his commodity

The price of a commodity for future delivery (futures contracts) usually tends to fluctuate in parallel patterns with the same commodity that is being produced by the farmer So, he can become "hedged" by selling futures in amounts equivalent to his inventory of the same commodity in its actual physical form This is the most common form of hedging

The term hedging, as it applies to any commodity which has the benefit of futures trading, means the taking of such action as will result in offsetting possible losses in transactions previously made or about to be entered upon Actually, when expressed in terms of action, it involves one of the following

(1) The sale of one or more futures contracts to eliminate or lessen the possible decline in value of ownership of an approximately equal amount of the actual commodity This is called a "short" hedge

(2) The purchase of one or more futures contracts to eliminate or lessen loss from the possible advance in the value of the actual commodity not yet owned, and needed to fill processing or other commitments at set prices. This is a "long" hedge

Here is how it works Let's assume Tom Jones has a full corn crib and an empty pen for finishing steers Does Jones immediately go to the feeder cattle market and buy steers at whatever price is asked to pay on this particular day he happened to get the urge to buy? He may It is his money he is spending

But Reed suggests before he jumps into the pick-up truck and flys to the market, he take a moment, look at what the futures quotation is predicting the price to be for cattle in the month his steers will be ready for the fat cattle market Jones could find that information on the market pages of Lancaster Farming, of course He will see, if he looked last week, that Chicago cattle futures for the month of April are quoted at 29 10

This gives Jones an idea of what the people who have watched the market and its trends every day for many years believe steers will be worth in April. "No other businessman will go out and buy in when he has no idea what his product is going to sell for when it is ready for market," Reed said "So why should the farmer do that."

After Jones sees the future quotations, he figures how much it will cost him to feed the cattle and how much profit he is satisfied to receive. When he has this total, he slowly steps into the pick-up truck and drives to the market with a figure in his head that would be reasonable to pay for feeder steers. If the feeders can't be bought to make a reasonable profit, they should not be bought at all.

In our example, Jones buys steers, and has them trucked to his feed lot the same day.

Now, is Jones' worry about over? Well, not quite. Since he figured a profit into his steers before he bought them, his worries would be over if he knew the price was not going to go down. But sometimes it does, so here is where the farmer can use the futures.

If he is truly sure that the profit figured at the current futures quotation will be satisfactory, he can sell his steers on paper the same day he buys them by selling a futures contract through a broker.

The Futures Contract

The mechanics of commodity futures trading are easier to grasp when you understand the futures contract. It is called a futures contract because it requires delivery of a commodity in a stated month in the future — if not liquidated before the contract reaches maturity

The rules and by-laws of the commodity exchange, where the trade takes place, is an implied part of each transaction

Trading on the futures markets is fast and smooth because every futures contract for a specific commodity is identical as to quantity and quality provisions. Thus, as far as the futures trader is concerned "wheat is wheat" and "beef is beef" Every live cattle contract is for 40,000 pounds of choice grade steers and every wheat contract is for

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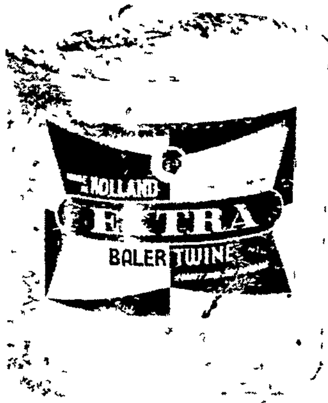

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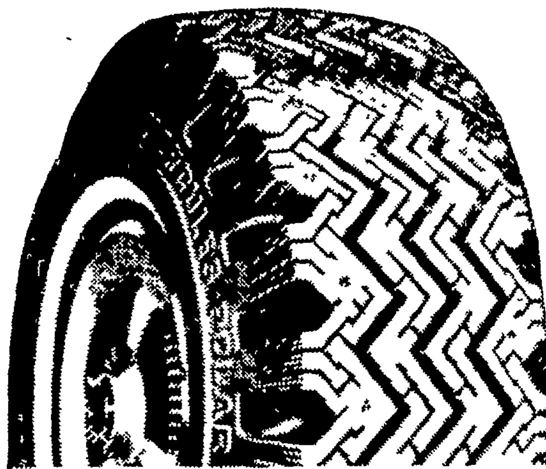

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