

A Look at the Futures Market

What is the futures market?
The futures market is the organized and regulated buying and selling of contracts for farm commodities to be delivered and paid for on some future date.

The uniqueness of the activity is that most traders don't actually want the commodity so they sell the contract before delivery, sometimes at a profit, other times not.

What farm commodities are most actively traded?

Wheat, corn, oats, soybeans, cotton, wool, shell eggs, potatoes, soybean oil, soybean meal, live beef cattle, live hogs, frozen pork bellies (bacon), and frozen concentrated orange juice. Corn led the trading volume in 1970-71 with over 2.7 million transactions.

Ass this trading was under Federal supervision.

Where are the major markets?

The two largest are in Chicago, with others in Kansas City, Minneapolis, New York, and one just underway in Los Angeles.

These markets handled over \$115 billion worth of trading last year compared with \$92 billion in 1969-70 and \$83 billion 5 years earlier.

How does futures trading work?

It's based on a difference of opinion. Here's an oversimplified explanation.

Those buying futures contracts usually expect prices to increase for the commodity as the delivery date nears. Sellers, on the other hand, usually feel prices will glide lower near delivery time.

Let's look at an example for wheat. A futures contract for a bushel of wheat to be delivered in March of 1972 sold for \$1.54 on September 8, 1971, in Chicago. The price for that contract had varied in previous trading from about \$1.75 to \$1.46.

That \$1.54 contract might start rising toward \$1.75 again before March and be sold, perhaps to someone who thinks it would go even higher. On the other hand, if the price begins to slip and the contract owner doesn't want the wheat, he could sell before March 1.

What is the value of futures trading to farmers?

Futures trading brings prices into the open; it increases the range of information and judgments brought to bear on the price.

Second, futures make it easier for farmers and other businessmen to choose a preferred course of action.

For example, a grain grower can sell his crop on the futures market and earn a storage fee for holding the grain. Then, as delivery time nears he can buy his contract back and sell the grain for cash.

Exporters can accept overseas orders for grain they do not have on inventory because futures give them a temporary ownership position until they find the grain.

Third, futures trading facilities financing for farmers and others. Grain inventories that are properly stored and hedged in futures can serve as collateral for up to 90 per cent of the value of a low-interest loan. These loans free up the operator's capital for such things as more modern machinery.

How do futures contracts help stabilize returns for farm commodities?

It is important to realize that those who use the futures market make it possible for processors, distributors, and farmers to reduce some of their price risks.

If a wheat miller, for example, takes orders from bakers for flour to be shipped in six months,

Editor's note: Futures markets have long been understood as an arena for speculators, those who don't need or want to own commodities such as eggs, various vegetables, live animals and others, but who are willing to risk their money and judgment on the future prices of these products.

But as farming becomes more complex and requires larger inputs of capital, the futures markets are also becoming recognized as a proper concern of farmers.

While speculators use the markets to maximize risks and potential profits, farmers often use them to minimize risks and to assure that good prices which are available now will still be available when the crop or animals are ready for market.

For instance, farmers who early this year had the wisdom to anticipate the good corn harvest which caused corn prices to drop sharply could have "locked in" the high prices with futures contracts.

Futures markets are highly complex. If used unwisely, they can be very costly.

But the indications are growing that many successful farmers and agribusinessmen consider futures markets to have a place in a well-run enterprise.

In the accompanying article, Dr. Allen Paul, head of the USDA's Competition and Pricing Branch, Marketing Economics Division, Economic Research Service, answers some basic questions about futures.

he can buy wheat futures now and thereby fix his wheat cost by taking delivery at the contracted price.

What price best reflects the prospective supply and demand at a given time—cash or futures?

There usually is little difference, except in the case of nonstorables like eggs, potatoes, and livestock. In these cases, futures traders buy a contract due 8 to 12 months in the future. Cash prices for products can reflect supply and demand prospects for only about a month or two. Thus, prices for distant

delivery extend the evaluation of the market situation.

What about storables?

Well, for storables, such as grain, cash prices for immediate delivery reflect distant prospects just as much as futures prices do.

To illustrate, in mid-April, No. 2 yellow corn at Chicago was \$1.54 and December futures were \$1.47—both high prices for recent years—reflecting fears of extensive blight damage to the 1971 crop.

But by mid-August such fears had subsided and both price barometers had declined \$0.24.

Thus, cash and futures were similarly affected by the marked change in thinking.

What is your viewpoint of the future of futures?

The future of futures looks healthy. The major source of growth in futures trading since World War II has been the expansion and increased specialization of the feed-livestock economy.

Four times more corn and 12 times more soybeans are being sold from farms than in 1939-41

and the increased volume of corn and soybean futures trading reflects this expansion.

Recent introduction of futures trading in live cattle and hogs also is a manifestation of growth and specialization of the feed-livestock economy.

On the other hand, the old standbys of futures trading—cotton and wheat—have not shown as much vigor for related reasons. In the past two decades, low prices for grain often meant that prices were at or near Government support levels, whereas high prices meant the opposite. Yet in recent years with the changes in farm programs, future volume has been coming back.

'70-71 Futures Volume Is Up

During fiscal 1970-71, a record 11.8 million futures contracts were made. Last year's record represented a sharp increase of over 14 per cent compared with the 10.3 billion total transactions traded during 1969-70. Here's a rundown of trading volume among the most active regulated commodities:

Commodity	Thousands of transactions
Corn	2,748
Soybeans	2,686
Frozen pork bellies	1,526
Soybean oil	1,464
Wheat	847
Soybean meal	634
Live beef cattle	606
Shell eggs	524
Potatoes	238
Live hogs	191
Cotton	166
Frozen concentrated orange juice	117
Oats	77

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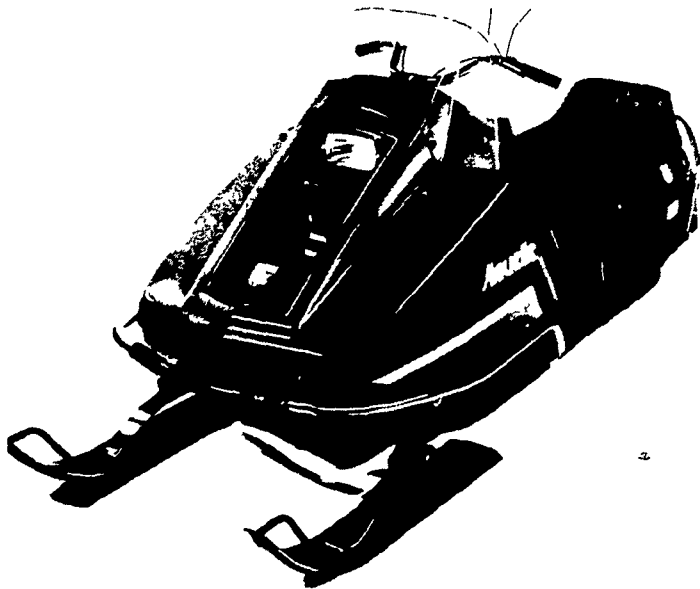
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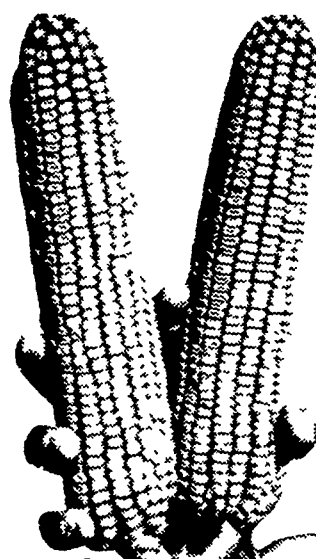
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