Farming's Futures

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Is there a best delivery month in which to hedge?

The fact that the price is the highest for one particular futures delivery month—that the July futures prices, for example, is higher than the May futures price—doesn't necessarily mean this is the most profitable month in which to hedge. Or that it will necessarily yield the highest net payment for storage.

To make this decision, you need to take into account not only the various futures prices and the carrying charges they reflect but also the probably basis. It's yet another way in which basis knowledge can be useful—and, indeed invaluable—in making marketing decisions.

For example assume the May futures price of corn is $2.50 and the July future price is simultaneously $2.56. At first look, that appears to be a payment of 3 cents a month for storing corn from May to July.

But if your records indicate the normal basis for your area is 20 cents in May and 24 cents in July, the futures market is offering you a net of $2.30 ($2.50 minus 20 cents) for corn delivered in May and $2.32 ($2.56 minus 24 cents) for corn delivered in July. Chances are you would want to think twice before storing corn for a payment of a penny a month.

What action can a hedger take if the basis is unfavorable?

Assume the same facts as in the previous example except that, as the delivery month is approached, the basis is a much wider than expected 35 cents a bushel. Selling your crop locally and lifting the hedge that was placed at a futures price of $2.50 would net you only $2.15 for your corn. What can you do about it?

One alternative to consider is moving the hedge forward into another delivery month in the hope that it eventually can be lifted at a higher net price. That is, that the futures price minus the basis will be higher than $2.15 a bushel.

Moving a hedge forward can be accomplished simply by buying in the existing futures contract and simultaneously selling a similar contract in a later delivery month. Such as by buying in a March contract and selling a May contract. Or by buying in a May contract and selling a July contract. Any carrying charge difference between the two contracts should provide you a payment for the extended storage.

Example: Assume (for the sake of simplicity) that the March contract sold at $2.50 is still $2.50 and that the local cash price is 35 cents lower at $2.15. If you decide this is an unacceptably low price, you may wish to buy in the March contract and sell a May contract at, say, $2.58. If the basis by May returns to a more normal 25 cents, you will be able to sell your crop and lift the hedge at a net price of $2.33 a bushel (the futures price of $2.58 less the 25 cents basis).

Can a hedge be lifted sooner than planned?

A hedge can be lifted at any time simply by buying in the futures contract at the prevailing price. There could be circumstances in which this might be to your advantage.

For example, assume that at harvest you placed your crop in storage and, in order to protect yourself against a possible decline in price, by hedged by selling a futures contract. Since then, however, there are indications that prices during the spring and summer may move sharply higher. To take advantage of the expectated higher prices, you may decide to lift the hedge. (The risk that you run in doing so, of course, is that time may prove that you were wrong about the direction of prices.)

Another opportunity to lift a hedge earlier than planned could result from a sudden and unexpected narrowing of the basis — due, for example, to a significant increase in the local price relative to the futures price, or from a larger decline in the futures price than in the local cash price. Lifting the hedge and selling your crop sooner than planned to take advantage of the narrow basis could result in a higher price and savings on storage costs.

In addition to the situations just discussed, you may want to lift a hedge sooner than anticipated simply because the cash price of the commodity has declined to a level at which you are now willing to own it without price protection. Any subsequent increase in the price once the hedge is lifted should then result in a profit (to the extent the increase exceeds storage costs).

Send your questions on futures trading to Farming's Futures, Lancaster Farming Newspaper, Box 366, Lititz, PA 17543.

U.S. Senate approves agricultural nominee

WASHINGTON, D.C. — By an affirmative voice vote, the Senate last Wednesday approved the presidential nomination of Kalo A. Hineman to be a commissioner of the Commodity Futures Trading Commission.

Last Monday, the Senate Committee on Agriculture, Nutrition, and Forestry held hearings on Hineman's nomination. In a meeting Tuesday, the Committee unanimously recommended to the Senate that the nomination be approved.

Senator Jesse Helms, chairman of the Senate Agriculture Committee, said, "Kalo Hineman will provide an excellent service to the CFTC. With his extensive and intimate knowledge of the day-to-day workings of agriculture, he will bring a special — and necessary — dimension to the CFTC."

Hineman, a native of Dighton, Kansas, has been farming for 34 years. He and his son operate a 2,500-acre wheat and milo farm. On an additional 2,500 acres, they also have a 200-head cow-calf operation. Hineman is also involved in marketing stocker calves and yearlings as well as finished cattle.

He has been a member of the Kansas House of Representatives since 1974. He has also been active in numerous agricultural organizations, including the Farm Bureau, the Kansas Association of Wheat Growers, and the National Cattlemen's Association.

During the confirmation hearings, Hineman said, "My wish is that my tour of duty as a CFTC Commissioner will be parralleled by a substantial increase in the level of public understanding and of justifiable confidence in futures trading and futures trading markets."

The Commodity Futures Trading Commission is an independent federal agency responsible for regulating futures trading. The CFTC's regulatory and enforcement efforts are designed to ensure that the futures trading process is fair and that it protects to both the rights of customers and the financial integrity of the marketplace. CFTC Commissioners are appointed by the President for five-year terms.

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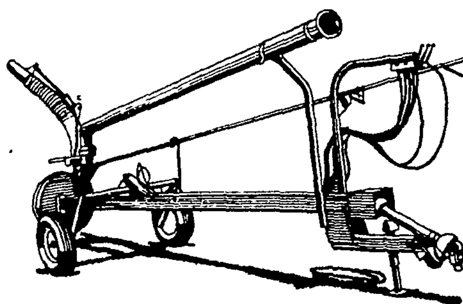

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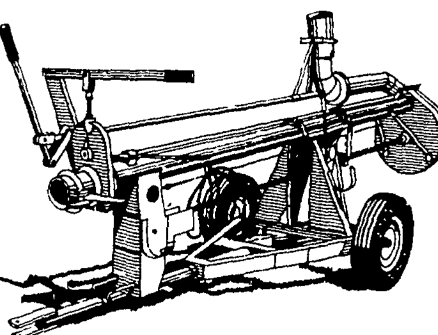

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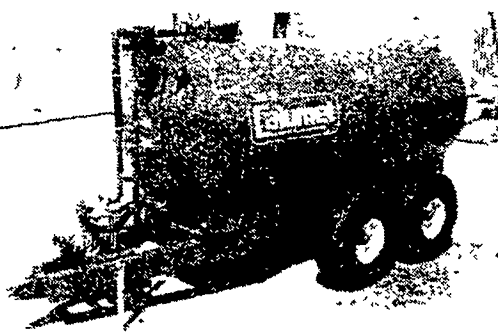

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