

Farming's Futures

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Pitfalls of Farmer Hedging

Commodity hedging is not something to be entered into lightly, without extensive study and preparation. Farmers who make the decision to hedge without considering the risks, along with the benefits, have already made their first mistake.

As a guide for inexperienced hedgers, here are some major pitfalls into which farmers have fallen in the past:

Bypassing the basis

The first step in using futures markets effectively is to study your local basis — the difference between the futures market price for a selected month and your local spot market price.

Without knowing your local basis and how it typically behaves, you have no way of knowing whether the price offer by the futures market is attractive.

Slipping into speculation

Countless stories tell of farmers who "lost big money" in hedging programs. All too often, it turns out that the farmer who lost money had gone beyond a safe hedge into a risky speculation.

Hedging is a temporary substitute for a cash transaction planned later for the physical commodity — a grain farmer selling the crop, a feedlot operator buying feed or feeder cattle, or a hog producer selling hogs.

If a particular transaction is not clearly a hedge, then it should be recognized as speculation.

When you hedge, the odds are in your favor if you understand the futures market, have a good fix on your production costs, and lock in prices that will provide satisfactory returns. The odds shift dramatically when you start speculating.

Becoming a "know-it-all"

There's an old axiom among the floor traders at every futures exchange: "The trader who is certain where the market is going has no business here, and won't be here long."

Overconfidence — whether based on some advisory service's "guaranteed formula," your own extensive research, or even the success of a well-planned hedging program — can encourage risk-taking and court disaster. No one knows for certain where the markets are going, or when.

Floor traders make money and then lose it. The speculator who writes a book on how to make a million dollars in commodities may be broke before the book is published.

Even one of the major grain companies lost more than \$80 million in one 3-month period a few years ago (primarily in cash market commitments) because it misjudged the soybean market.

Futures prices at any given time reflect all that is known and all that is expected on the value of commodities being traded. This is why a bearish crop report is often followed by a price increase —

because the traders had expected an even more bearish report than they got.

In other words, you should always assume that any information that comes your way has already been analyzed and acted upon by other traders who devote 100 percent of their time to futures markets.

But while "professional" traders may have faster access to a more complete picture of the overall supply and demand situation, you probably know the production situation in your own area more intimately than anyone outside that area. So your comparative advantage is in hedging your own risks, judged in light of your own costs.

More pitfalls next week.

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

MMI looks at end-product pricing

STRONGSVILLE, OHIO — The voting delegates of Milk Marketing, Inc. passed a resolution at their recently held mid-year delegate meeting that would begin the component pricing system for their members' milk September 1, 1983.

The program, originally presented at the December 1981 delegate meeting, was scheduled to begin January 1, 1983. The newly established September deadline will give MMI members an opportunity to further evaluate the program.

With the start of the protein pricing program, MMI will pay its producer/members at a higher rate for milk containing high levels of protein.

MMI Board Member from District 20 Gary Michael, Sidney, Ohio told the 250 delegate meeting

at the Fawcett Center in Columbus, Ohio that the implementation of this program could enhance the taste and nutritional image of fluid milk and therefore, improve future Class I sales.

The protein pricing program could also assist MMI in even more effectively marketing members milk by putting MMI in a better competitive position.

Other reports from MMI officers painted a successful financial year for the 9,400 member dairy cooperative. President Norman Alger, Mantau, Ohio stated that long term debt of the co-op has been reduced, while maintaining the working capital requirements established by MMI's financial institutions. Alger also said member equity for the co-op has increased more than \$3 million during the past year.

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