Corn Club Posts Complete Contest Results

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CORN TALK NEWS
PENNSYLVANIA MASTER CORN GROWERS ASSOC., INC.

Corn Futures and Options Farm Management Exercise

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The farm management exercise this past summer evaluated the use of futures and options to manage price risk Early indications were that carryover stocks of corn would be less than 5 percent of use, which would have been the lowest ratio on record In mid-summer prices skyrocketed and were extremely volatile Cash market prices were in excess of $5.50/bushel or nearly double what they were at the same time in 1995

When I wrote up the exercise back on July 10, the Chicago futures price for December corn was $3 58 December basis over the past 7 years has averaged +$0 15/bushel, this meant that the Pennsylvania price in December was expected to be around $3 73/bushel as of last July 10 On December 16, corn was selling for an average of $2 87/bushel in Pennsylvania ($2 91 in the southeastern part of the state, $2.86 in the central part, $2 79 in the south-central part, and $2 94 in the western part) What happened and when?

Prices for December futures peaked in mid-July at around $3 90/bushel By early to mid-August, corn futures prices had dropped to around $3 15/bushel Much of this was due to the discovery of additional corn stocks and the substitution of other feeds Prices rallied in mid-late August, but went into a steep decline on the news of higher than expected early harvest yields and lower export sales The extremely low stocks also led to regional shortages that reduced the corn consumption rate in late summer As a result, the final stocks of 426 million bushels were somewhat higher than expected earlier As additional information on the size of the national corn crop revised production estimates upwards, December futures prices have fallen to $2 67/bushel as of December 16 The latest USDA crop report puts the 1996 corn crop at 9 27 billion bushels (the third largest crop on record), up almost 16% from earlier estimates of 8 billion bushels Carryover stocks are expected to be over 1 billion bushels next September

What would have happened if we would have bought a put option for a December futures contract in mid-July, late-August, or even as late as early-October? In mid-July the futures price was around $3 60/bushel This means that we could have locked in an actual net sales price of $3 73/bushel by exercising the option to sell a futures contract [1] In late-August the futures price had rebounded to the $3 50/bushel level after falling to around $3 20/bushel earlier in the month At this point we could have locked in an actual net sales price of $3 63/bushel with the option[2] In early October the futures price had fallen to around $3 00/bushel However, even at this late date we could have locked-in an actual sales price of $3 13/bushel[3] The important point is that even if we locked-in the price after the late July highs, we would have an effective price above what the local market cash price is in mid-December

Corn Futures and Options Farm Management Exercise (continued)

The farm management exercise generated little interest this past year A total of twelve corn club participants returned their surveys Of this twelve only four indicated they would either sell a futures contract or buy a put option The remaining eight decided to take their chances on the cash market Taking their chances could have cost these producers over $1 00/bushel Even if prices had increased over the futures price, the only cost would have the premium and brokerage fees on a put option and the corn could still have been sold for the higher price[4] Although the volatility of the 1996 corn market was unusual, it does point out the benefits of futures and options as part of a marketing strategy that manages price risk rather than solely taking your chances on the cash market

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Notes

[1] Mid July futures price minus the December 16 futures price plus the local cash market price minus the brokerage commission

($3 60 - $2 71) + $2 87 - $0 03 = $3 73

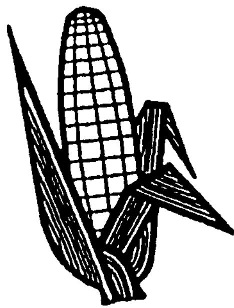
[2] Late-August futures price minus the December 16 futures price plus the local cash market price minus the brokerage commission

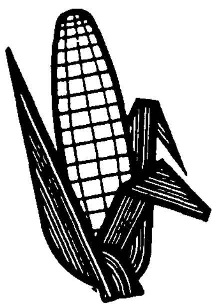
($3 50 - $2 71) + $2 87 - $0 03 = $3 63

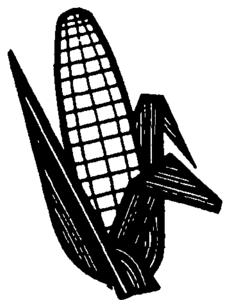
[3] Early-October futures price minus the December 16 futures price plus the local cash market price minus the brokerage commission.

($3 00 - $2 71) + $2 87 - $0 03 = $3 13

[4] For example, on July 10 an option to sell a futures contract at $4 10 had a premium of $0.62 On August 20, an option to sell a $3 40 futures contract had a premium of $0 20 In the first case, we were locking-in a minimum price of $3 45/bushel ($4 10 - $0 62 - $0 03) In the second case, we would have locked-in a minimum price of $3 17/bushel ($3 40 - $0 20 - $0 03) If cash market prices increased above the futures price, we would benefit from the higher cash market price, but the option would then be worthless







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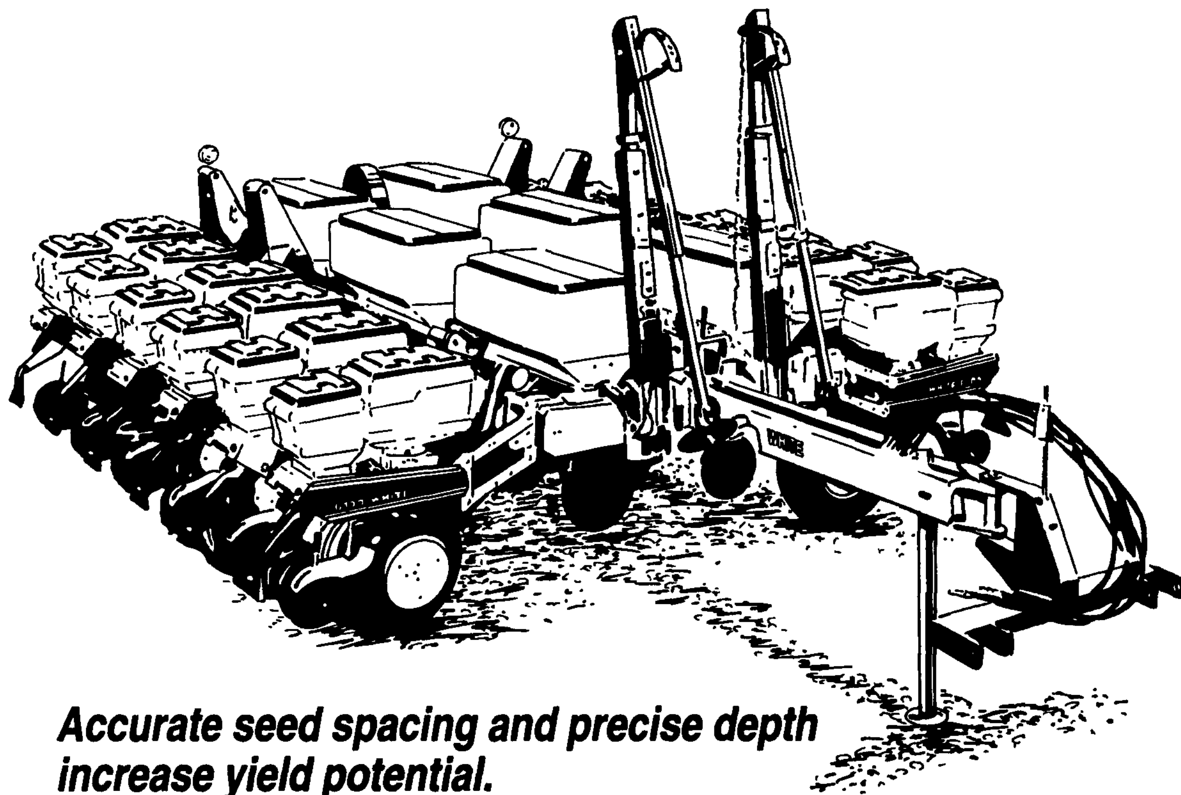

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