

Hedging, Options, Futures May Spell Survival

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that are enforced upon non-ag exports to such countries as India.

Trade will affect markets at home and offers a more aggressive stance for farmers to become involved in futures marketing.

While the government is pulling out of price supports, it is offering support in transition (an optional pilot program is available in which the USDA through a government subsidy pays 80 percent of costs for producers to participate in the futures market).

"Success in farming depends on the ability and willingness to adapt," Redding said of changing times.

Explaining the fundamentals of the futures markets were Eric Maine of the New York Board of Trade, Coffee, Sugar, and Cocoa Exchange Division and Dr. James Dunn, Penn State ag economics professor.

Maine gave the perspective of futures (the buying and selling of contracts) from the floor of the New York Board of Exchange. He said that the company foresees the dairy pit becoming as busy as the Coffee, Sugar & Cocoa Exchange. Milk is a commodity that is crucial and has the potential for investors to make a profit from rising prices as supply meets demand head on, Maine said.

Businesses that need milk don't want to bother with fluctuating dairy prices but want to lock in prices so that they can more effectively calculate a business plan.

Farmers can take advantage of this if they calculate their costs and lock in at a price that covers expenses. Although milk prices may rise higher by the time the farmer is ready to sell the milk, at least, he isn't suffering a loss. If the market drops, he makes a higher profit.

Over a long period, a farmer who uses the market may end up with the same amount of money as the farmer who doesn't. The advantage is that locking into the futures market guarantees a more consistent income rather than the highs and lows that cause cash flow problems.

Dunn explained in lay language the many terms associated with the futures markets.

The most often used terms and their definitions are some of the following:

Futures — A uniform contract for future delivery, in which everything is specified but the price; quantity, quality, delivery time,

delivery place, penalties, and premiums.

Options — The right, but not the obligation, to either make or take future delivery of a commodity. The advantages of options is protection against lower prices (for someone buying a put), while allowing the farmer to receive high prices if they occur. The disadvantage is that higher costs are exacted for protection than those for futures.

Puts — The option to sell a futures contract during a fixed time period for a fixed price.

Calls — The option to buy a futures contract during a fixed time period for a fixed price. Useful to protect a hog farmer against higher corn prices.

Basis — The difference between contract price and your local price at the time you expect to close contract. According to Dunn, generally grain prices in Pennsylvania are 15 cent a bushel higher than in Chicago, where the prices are set.

Hedging — Using the futures market to protect yourself from price risk in the cash market. Hedging locks in today's prices for tomorrow's needs.

Speculation — Using the futures market to try to make money by anticipating price moves on the commodity. Because of the margin, you can control several times as much grain as you could otherwise, allowing for big gains or losses.

Dunn took conference participants through a worksheet, as an example, to show how hedging can protect the future of corn.

Hedging can reduce risk if you grow corn and have a crop in the field, he said. You could sell a futures contract and lock in a post-harvest price. The profit or loss on the futures contract should offset the profit or loss due to local price changes.

One of the most used terms in milk futures and options is BFP an abbreviation for basic formula price. The BFP is government-calculated and based on the minimum price for Class III milk, before premiums.

Understanding the futures market is an ongoing process and not one that should be undertaken lightly with only a one-day workshop, Dunn said.

"Despite what anyone tells you, no one knows where the market is going," Dunn said.

Another word for speculation, he said, is "gambling," because you're betting money on what you

think the market will be doing. Of the millions of contracts made only two percent are actually delivered, but all contracts affect trading prices.

On the positive side, Dunn sees using the futures market as a good way for farmers to protect their profits. Not only can they lock in prices for crops growing in the field, but according to one participant, "I get 5 cents more a bushel for my corn just because the buyer knows I am aware of prices."

An excellent way to learn more about the futures market without risking finances is to become involved in a marketing club.

John Berry, Lehigh extension agent, and Ricky Butz, executive loan officer for Keystone Farm

Credit, told how a group of farmers formed the Lehigh Valley Grain Marketing Club and how they use scenarios to sharpen skills to prepare eventually for using the market.

"We learn how to come up with the best marketing strategy to get the best prices," Berry said.

Marketing clubs offer practical skills and emotional support in learning the ins and outs of using futures marketing to the best advantage. One time club members combined resources to place an order, which offered the advantage of spreading the risk and learning the market.

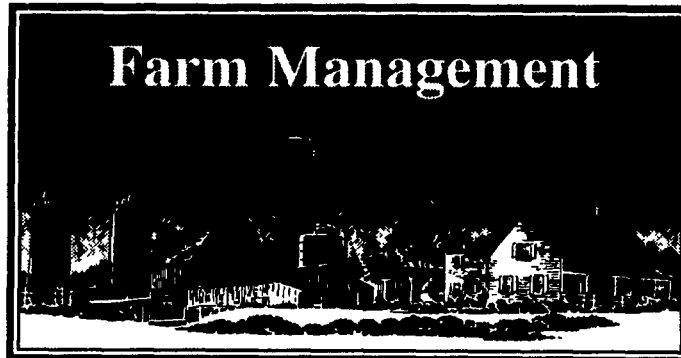
The purpose of the Ag Horizons conferences is to teach educators, such as extension agents and

teachers, about ag issues.

"Educators who can impact the classroom and decision making must learn to deal with markets during this crucial time," said Charles Suloff, who was part of the planning committee.

The conference was sponsored by the Southeastern Regional Council of the Pennsylvania Council of Cooperatives and Penn State's Cooperative Business Education and Research Program.

For more information about futures marketing or about becoming a part of a future's marketing club, contact Dunn at Penn State Extension (814) 863-8625, or John Berry at (610) 391-9840, or Ricky Butz at (610) 395-6831.



Farm Management

Dennis Ginder
Farm Management Agent
Penn State Cooperative
Extension

There are various types of personal and business planning. For the individual, this may include planning for retirement or your children's education. As business managers (yes, farm operations are businesses), there are additional types of planning which include business, contingency and succession.

The question many of us have is whether planning is beneficial. If we've thought about planning, too many times the "yes, but's"

have raised their ugly heads. Most of you have either heard them or used them yourself. Yes, but I don't have time. Yes, but there is no way I can know what will happen tomorrow, much less six months from now. Yes, but I don't know how to do that planning stuff. Yes, but there are other items we must buy today and therefore don't have the money to save. The list goes on.

It was George Hewell who said "Those who fail to plan, plan to fail". I've also heard it said that if you don't know where you want to go, any road will take you there. My suggestion is that if

you do not plan, most of your time will be spent dealing with crisis management or completing insignificant tasks while ignoring the important issues. Also, if planning is not part of your personal and business life, a few questions quickly come to mind. What goals do you and your family have? If you have goals, how do you plan to achieve them? How do you plan to pay for your children's education? How will you fund retirement, if you'll even be able to retire? How will you pass the farm on to the next generation? How will you develop your successor's management skills? How will you determine if you can afford to expand your operation?

Any type of planning requires a significant commitment from all those involved in the process. It requires communication and honesty from all participants. Tough questions need to be asked and answered. Finally, planning is an on-going process and not a once and done event.

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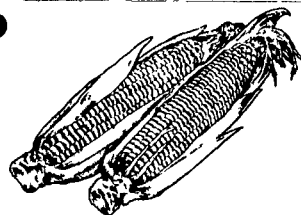
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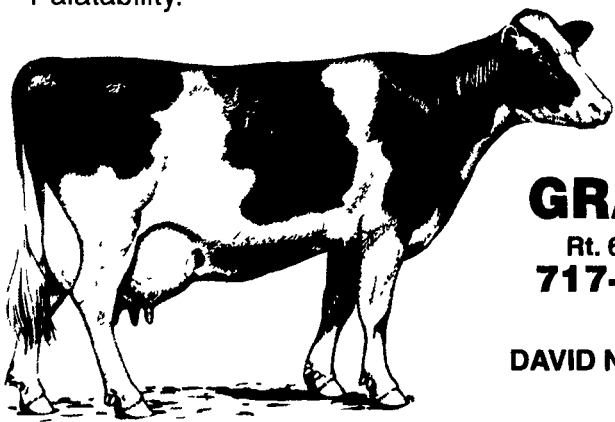
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