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Grain Futures An Alternative Market Tool

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Grain Futures
An Alternative Market Tool

If one will learn the relationship of grain futures prices to the cash prices in his locality, then he should have no more doubts about his judgment of futures prices than he now has of cash grain prices.

There are several ways the grain futures market can be used to reduce risk and offer marketing alternatives for farmers, grain elevator managers, farm managers, bankers and others associated with agriculture. Two of the more important ways are as follows:

1. Grain futures may be used to establish a price for a pending crop. To the person who understands grain futures they offer a means of selling a crop nearly a year in advance if a satisfactory price is offered. One may make a pre-harvest sale before a crop is planted, while it is growing, or anytime before delivery to the grain elevator.

A farmer who understood futures prices, realized on June 17, 1971 that the Chicago December corn futures price of $1.62 represented a local price to him of about $1.35 per bushel. This was a price for which he was willing to sell his growing crop. He sold Chicago December corn futures at $1.62 and in the amount of bushels of cash corn he expected to grow and sell. At harvest time he delivered his corn to the local elevator for 87 cents, and bought back the futures for $1.15. Thus he realized $1.34 base price for his corn while his neighbors got the current market price of 87 cents.

1971 EXAMPLE

Cash

June 17 Cash Price $1.35

Nov. 18 Sold Corn to Elevator for 87¢ Base Price

Futures

June 17 Sold 5,000 bu. Chicago Dec. Corn @ $1.62

Nov. 18 Bought back 5,000 bu. Chicago December Corn @ $1.15

Gain of 47¢

Actual price for corn: 87¢ + 47¢ = $1.34

2. The grain futures can fix the price of grain in storage for future delivery and pay the owner for storage. Many were taught for their introduction to hedging that the cash price and futures price move in near perfect unison and thus forms a hedge. This is mostly true for the short term, but it is very untrue for the long term; and the greatest profit opportunities are in the imperfect action of cash and futures markets.

During harvest the cash and futures historically spread apart, and after harvest they begin coming together again. This is caused by the fact that buyers can't buy all their year's grain needs at harvest, so the cash price moves away

from the futures to encourage storage until the grain is needed. In 1971 many farmers and elevator operators lost substantial amounts of money by holding the relatively high priced corn into the summer.

The following series of actual 1971 prices could have been turned into substantial profits instead of losses by use of the grain futures.

Local Elevator Cash Price

November 1, 1970	$1.18
June 14, 1971	$1.34
August 16, 1971	$1.07

Futures Price

$1.58	Chicago July
$1.57¼	Chicago July and September
$1.24	Chicago September

(a) On Nov. 1, a futures contract could be sold to protect against loss. On June 14 this hedge could be satisfied at no loss on the futures trade and a 16 cent a bushel gain in the cash price. (b) Then on June 14 another hedge could be placed in the September futures. Thus on August 16 when the corn was shipped out there was a 27 cent loss in cash price offset by a 33 cent gain from the futures transaction for a total price of $1.40 for the corn instead of $1.07.

Cash

June 15 Cash Price local elevator $1.34

August 16 Sold Corn @ $1.07

Loss of 27 cents per bushel

Futures

June 15 Sold Chicago Sept. Futures @ $1.57¼
August 16 Bought Back Sept. Futures @ $1.24
Gain of 33 cents per bushel
Actual Price for Corn: $1.07 + .33
$1.40 cents per bushel

For more details ask for Bulletin 590, Farmer Use of Grain Futures, at your county extension office or the Economics Department, So. Dak. State University.

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