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## Benefits from Understanding Futures

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# Economics Newsletter

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## BENEFITS FROM UNDERSTANDING FUTURES

Understanding grain futures can benefit a farmer in making decisions necessary for the operation of his daily business - even if he never trades in them.

- \*By understanding and differentiating old and new crop futures, he can better decide which crop may be the highest priced in the fall, and plant accordingly.
- \*By understanding carrying charges and deferred futures, he can better decide whether to sell or store, and how long to store.
- \*By understanding new crop futures, he can assess the value of next year's crop and sell at a satisfactory price before the crop is planted, or grown or harvested.
- \*Understanding futures can aid him in assessing his own local price, and help determine whether a strong local market is temporary.
- \*An understanding of both livestock and grain futures can aid him in deciding whether to feed livestock or sell cash grain.
- \*Understanding grain futures is important in making decisions as to the marketing of cash grain.

Rapidly changing marketing conditions, including the diminishing influence of crop support prices, make individual farmer market evaluation more important than in previous years. Consideration and understanding of grain futures is important to total farmer market evaluation.

## Futures Markets as Price Indicators

Many people want to believe futures markets predict future cash prices. There may be a very little difference in being a price indicator or a price predictor, but futures do not predict future cash prices. Perhaps if we define futures prices, this distinction will become more clear.

The commodity futures market is designed to reflect all known factors and register a price for the present (nearby futures) and into the future (deferred futures). In other words, the future prices represent what the majority of traders know now about the various factors affecting price, now and into the future. Tomorrow the traders may acquire additional or different information and their assessment of futures prices may change. Thus, we can say futures prices indicate what the majority of traders are willing to pay right now, based on what they know right now, for grain to be delivered at a specified future date.

## What Grain Futures Mean to Local Prices

In order to gain the most benefit from understanding grain futures, he should learn what the futures prices mean to him in local prices. These futures prices-local prices relationships are predictable within certain limits so it is possible to tell from the futures prices what they mean in local prices for any time of the year. Corn and soybeans have had a predictable basis, based on the history of the past few years. Wheat has been predictable in most instances, but is limited in that futures do not reflect protein premiums. It can be assumed that as more wheat is marketed on the open

market, because of diminished Federal Commodity Credit activity, the base wheat price will become more closely related to the futures prices.

Local prices are most often less than the futures price being considered. They can, however, on some occasions, be over futures prices. The basis is determined by simply subtracting the local price from the future price and recording the difference. As an example, for September 1, the local price of \$1.31 subtracted from the Minneapolis March futures price of \$1.62 indicates the basis is 31 under, meaning the local cash price is 31 cents a bushel under the March future on that date.

### Future Markets and Carrying Charges

There is a cost for storing grain from one month to another, and the market should reflect that cost. Understanding carrying charges could help you decide how long you would care to store your grain. The higher the price of the grain, the more the carrying charge should be.

Understanding grain futures is beneficial in making many of the cash market decisions farmers face several times a year.

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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