

Farmer's Corner



March 2004

Number 3

What Are Prices Going To Do?

We're off and running. Where and when will this market end? There are plenty of predictions, and even if you ignore the logical question of why anyone who knows the answers would be spending their time sharing that information instead of trading it themselves, we're still left with an astounding and often contradictory variety of opinions to sort through.

When it all quiets down and the smoke clears, what prices have done or might do is a question of no consequence whatsoever. The only price that means anything is the one **you** sell for. That's the price that has to be measured against your costs. In times like these, excitement is stirred and emotions run the gamut from euphoria to nausea, but at the end of the day the simple business formula doesn't change:

(Bushels x Price) - Cost = Profit

The world of grain prices is a funny place. Prices are only a fact after they happen. The next minute's price, the next hour's price, the next day's price, and the next week's price, the next year's price, and so on, are nothing more than a fantasy until they've already happened.

. . .you might say that price prediction and farming are two almost entirely unrelated and separate enterprises.

Obviously, we can look at history and trends as a sort of shaky guideline (with no guarantees whatsoever), but deep down we all know that price prediction is an impossible pursuit. There are just too many factors that affect price. Weather, international crop conditions, world events, emotions, seemingly

unrelated news, and many, many other factors are part of the complex soup that is price discovery. No one really knows what's going to happen until it has happened.

In fact, you might say that price prediction and farming are two almost entirely unrelated and separate enterprises. That isn't to say that prices are not important to farming. A profitable price is second only to a healthy crop in its impact on your success. However, the pursuit of a particular price and the pursuit of the question "how high is this market going to go?" are not even close to being the same thing.

Let's make some comparisons between the cash grain farming industry and the price prediction industry to see if we can support the statement that they really are unrelated enterprises:

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Comparison between Cash Grain Farming and Price Prediction

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| <ul style="list-style-type: none"> ▪ Cash grain farming requires a farm. ▪ Cash grain farming requires soil to be worked, crops to be planted and cared for, and the cooperation of the weather. ▪ Cash grain farming requires an enormous investment of cash up front each year, and you can't change your mind once the crop planted. ▪ Cash grain farming must be done where there is farmable land. ▪ Cash grain farming, when all is said and done, is motivated by profit: more money must come from the sale of grain than went into the production of it. | <ul style="list-style-type: none"> ▪ Price prediction does not require a farm. ▪ Price prediction requires none of these. ▪ Price prediction requires only a few cents per bushel up front, and you get out at any time. ▪ Price prediction can be done in a skyscraper, boat, airplane, desert, mountain, anywhere. ▪ Price prediction is often motivated by the desires of those who sell the related information: commissions, fees, the sale of advisory services, etc. |
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What is the Current Profit Picture?

New crop prices are high right now. Why is this the case? We don't know much, if anything, about the 2004 crop yet. Often old crop rallies lead to new crop opportunities that wouldn't exist otherwise.

Use this simple formula to see what kind of profit potential current new crop prices are offering you.

Example:

PROFIT-AT-A-GLANCE

$$\begin{array}{ccccccc}
 \frac{\$6.10}{\text{Current Price}} & \times & \frac{50}{\text{Yield}} & - & \frac{\$225}{\text{Cost Per Acre}} & = & \frac{\$80}{\text{Profit Per Acre}}
 \end{array}$$

PROFIT-AT-A-GLANCE

$$\begin{array}{ccccccc}
 \frac{\text{Current Price}}{\text{Current Price}} & \times & \frac{\text{Yield}}{\text{Yield}} & - & \frac{\text{Cost Per Acre}}{\text{Cost Per Acre}} & = & \frac{\text{Profit Per Acre}}{\text{Profit Per Acre}}
 \end{array}$$

$$\begin{array}{ccccccc}
 \frac{\text{Current Price}}{\text{Current Price}} & \times & \frac{\text{Yield}}{\text{Yield}} & - & \frac{\text{Cost Per Acre}}{\text{Cost Per Acre}} & = & \frac{\text{Profit Per Acre}}{\text{Profit Per Acre}}
 \end{array}$$

Dealing with the "What Ifs?"

Current new crop prices are higher than they have been in quite some time. This raises two reasonable concerns in many producers' minds:

1. What if I sell and miss out on even higher prices?
2. What if I don't sell and have to settle for less later?

Here are a few ways you might be able to contract grain and address both of these concerns:

Price Averaging

This is a straightforward and easy way to get some sales made and be involved in market movement over a period of time. What if current prices are the highest we'll see, and prices begin to move lower as the 2004 crop develops? What if this is just the beginning and prices continue to climb as we move toward the next harvest? Averaging will keep you involved in all phases of the market, and more importantly, help take some of the emotion out of marketing. Ask us for more details on setting up an averaging contract. Minimum bushel requirements may apply.

Target Scaling

Again, discipline is the key here. By settling on some desired prices ahead of time and entering Target Contracts to sell if

those prices are reached, you can be sure you get the prices you're looking for if they become available, even if you're busy in the field or asleep when it happens! (The CBOT night trading session has produced some of the highs in recent years, and Target Contracts are the only way you can participate in that session). If you know what prices you're willing to lock in new crop bushels for, back those prices up by entering scaled Target Contracts so you can put your plan into action!

Stay in the Market with Options

The option market is a wonderful tool for locking in good prices and still being in the market if it takes off. There are costs involved, but you get a lot of value for the money. Staying in the market with options gives you the peace of mind of knowing a downside move in prices won't affect you, and the freedom to stay in the market if things take off. There are many ways options can be customized to your particular needs; you can choose more or less time, more or fewer bushels, and a higher or lower "deductible" depending on your unique needs. Give us a call to talk about how to stay in the market in the way that's best for you.

TARGET CONTRACT

I, _____, offer to sell
_____ bushels of
_____ to _____
at a price of \$ _____ per bushel.
Delivered To: _____
Delivery Period: _____

(Producer) Date _____ 20____

(Elevator) Date _____ 20____

TARGET CONTRACT

I, _____, offer to sell
_____ bushels of
_____ to _____
at a price of \$ _____ per bushel.
Delivered To: _____
Delivery Period: _____

(Producer) Date _____ 20____

(Elevator) Date _____ 20____

"Current" Events



Ever been swimming in the ocean? If you have, you've no doubt experienced a scenario something like this--you're out in the water, having a great time, when suddenly you look up at the beach and see a totally unfamiliar scene. The boardwalk you crossed the sand dunes on is nowhere to be seen. Your belongings and the people you came with are nowhere to be seen. Finally, looking way down the beach, you can barely make them out in the distance.

"How did that happen," you think to yourself, "I've just been swimming around in this one spot the whole time."

What really happened? While you were having fun and not really paying attention to the shoreline, the current has been slowly but surely pulling you along, so that by the time you notice what's happened, you've got a long swim back to where you started from.

Focusing on daily price movement has a way of getting your attention off of your most important goal; selling grain at a profit. By the time you realize what's happened, you're already pretty far off track. Remember, the principles of successful marketing are the same no matter where prices are. Have a simple plan to lock in a reasonable profit and stick to it.