

Questions and answers from Session 3
Managing Margin Risk

1. *The example you had with cash forward of soybeans being for 3,000 should be 5,000 bushels if you are going to use the option market choice.*

Options contracts are in units of 5,000 bushels, so our example should have been 5,000 bushels.

Contracts are rolled the day before first notice day.

2. *Is there a computer program or decision making tool that cranked out the information in the payoff diagram for old crop corn pricing alternatives slide that producers can use to plug in their numbers?*

3. *Is the chart/table on page 30 available as a spreadsheet or could it be.*

The payoff diagrams were drawn using Excel, based on the numbers calculated in the spreadsheet. I just use Excel from scratch every time, so there is no decision making tool at present. This is something we should work on for the future but will take time—thank you for the request!

4. *The futures and basis was shown that they can be locked in independently from each other, i.e. basis contract or futures contract. On the slide that was titled 'Central Indiana Cash Corn: Crops: 97-06', do you have anything that shows the history over the 5 year or 10 year history. Of these two components independently rather than together as cash?*

We have posted the PowerPoint slides with the Futures, Basis and Cash seasonality so you can compare the components separately.

5. *Explain the lack of convergence on wheat. Explain why the wheat at delivery point Toledo, OH will not move. What will encourage it to move, how many bushels is it, what % is it compared to world wheat supply. Explain the plan on what the CME is planning to do to solve it*

The lack of convergence on wheat has several possible explanations. One is that there simply are not enough delivery points for farmers to deliver on the futures contract. Second is that the storage fees for grain delivered on the futures contract are too low. The CME is making two changes to the wheat futures contract to hopefully restore convergence for wheat contracts: 1) the storage fees are increasing effective July 2009 wheat contract, 2) there will be new delivery points for CME wheat futures contract on the Ohio River between Cincinnati and the Mississippi River at par and St Louis to Memphis locations on the Mississippi at 20 cent premium to Par. Plus delivery can be made to more country elevators in a 12 county area of northwest Ohio at a 20 cents per bushel discount to par.

Some elevators that have been regular for delivery have not had a financial incentive to take futures delivery because they could earn more on holding their own wheat as opposed to taking futures delivery and receiving the (too low) storage charges. The increase in storage rates is designed to help this problem. More delivery points means there is a better chance of having some elevators who have room and want to take futures delivery.

Producers who are in Northeast Indiana or in Southern Indiana-close to the Ohio River-are expected to see wheat basis levels improve sharply vs. the past two years. However, elevators will be very hesitant to increase their new crop basis bids until they see how these new delivery alternatives impact the level of the futures and cash prices starting with the July 2009 futures contract.

Changes Noted Below are from a news article from Reuters December 4, 2008
<http://www.reuters.com/article/rbssFinancialServicesAndRealEstateNews/idUSN0439157820081204>

CONTRACT CHANGES

Based on Thursday's approvals, rates to store soft red winter wheat will rise to 8 cents per bushel per month from 5 cents for the July 18-Dec. 17 period of the crop year, which starts with the key harvest period. During the rest of the crop year, storage rates stay at 5 cents.

CME also will expand delivery points to include more Midwest rail and barge terminals, including large rail facilities in a 12-county area of northwest Ohio; barge loading terminals on the Ohio River from Cincinnati to the Mississippi River; and barge loading facilities on the Mississippi River from St. Louis southward to Memphis.

Current delivery points are Toledo/Maumee, Ohio; Chicago-area terminals; and St. Louis. The main soft red winter wheat belt runs from northwest Ohio down into Missouri.

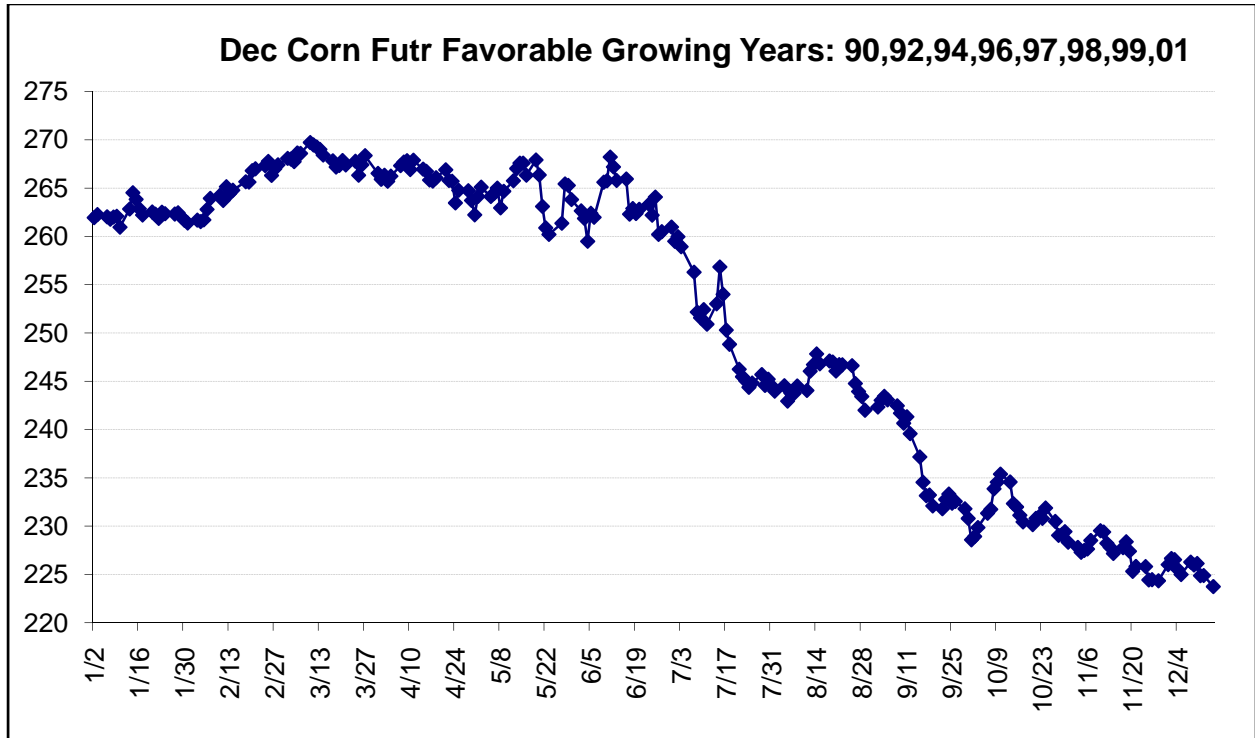
The new seasonal storage rates and delivery changes will be implemented starting with the July 2009 contract.

Additionally, the CME lowered the maximum allowable vomitoxin in soft red winter wheat for par delivery against the contract to 2 parts per million, from 3 ppm, starting with the September 2011 contract. (Reporting by Christine Stebbins; Editing by David Gregorio)

- 6. Would it be possible to have a graph for pre-harvest pricing strategies with long and average crops?*

We include here a chart of December corn futures prices on average for a series of large crop years. The conclusion: in years when we tend to get a national crop that is larger than normal, the price decreases from spring until harvest are larger than normal. If we think about the spring pricing window as providing a 25 cent higher price on average, in the chart below, we see the

spring pricing window provide about 30 to 40 cent premium. Roughly 25% of the time December corn futures and November soybean futures end up being higher at harvest than in the spring pricing window. Those years most often have been drought years. (Average crop years are in the class notes).



7. *I'm not sure I really understand the "Corn Central Indiana: Storage Returns: 1986-05 Crops" and the following slide. What can I conclude from them? By having the '86-05 crop line on the chart (that demonstrates the seasonality of prices - and how it's better to sell in the late spring than at harvest) imply that you can turn that into positive margin? If my interpretation is right - this doesn't make sense as it ignores our ability to independently make pricing decisions - as well as when elevators offer free DP. Would appreciate clarification here. I'm very new to this and one of the things I'm struggling with is the economics of storage.*

Yes, you can independently make pricing decisions from storage decisions. The Storage Returns slides ask the questions 1) what is the grain market paying for storage for spot delivery which is called the "carry"? and 2) Is the carry in the market large enough to cover storage costs? The reason we don't also consider all of the different pricing decisions is simply that there are an infinite number of forward pricing possibilities and depending on when you price for forward delivery, you could have very different returns from storage.

8. You may think this next question is in jest but I'm dead serious. What can we learn from history regarding the impact of DEEP recessions and depressions on grain prices? Perhaps a more general discussion I'd be interested in any insights/opinions you all have regarding overall macroeconomic conditions and their impact on grain prices.

Grains prices travel to the beat of a host of factors. Sometimes these factors impact the general economy and sometimes they do not. In current markets, it is clear that the big macroeconomic factors are drivers of grain prices as well. Those include: 1.) Weakened world incomes due to the global economic slowdown which is cutting ag product demand; 2.) The strong U.S. dollar is making it more expensive for our foreign customers to buy U.S. ag products; and 3.) Macro factors have helped collapse the oil prices and this has hurt demand to use corn and soyoil for biofuels.

Other periods when macro factors played heavily into ag prices were the 1970/1980s boom/bust and the period from 1997-1998-1999 after the Asian financial collapse. The big price cycles are generally affected by these big world economic events. A key to whether the big macro events are affecting prices is if all ag prices seem to be moving in the same direction at the same time.

Each commodity has its own supply and demand conditions. Thus, you may see corn move higher, but oil and metals do not. This may be because of poor yields for corn in a major growing area that affects corn prices, but not other commodities. Generally weather events have an impact for only one year. That is to say, prices move up quickly around the event (drought as an example), and down sharply as production returns to normal in the next year.