Exercise: Using Futures Contracts

This exercise will assist you in using futures contracts. Portions of the module will ask you to use the Internet to gather price information, but you can get the same information from the newspaper or by speaking to a broker.

**Step 1:** Using the Chicago Board of Trade website (or other source for price quotes), fill out Table 1 which lists futures prices for the soybean, corn and wheat futures contracts. Then answer the discussion questions at the bottom of the page.

**Step 2:** Page 3 of this exercise asks you to perform a storage hedge and to compare its returns to storing with a cash forward contract. Complete the calculations and answer the questions at the end.
Fill out the following table by writing in the closing futures prices and answer the discussion questions below. When filling out the contract months, begin with the closest month and go to the latest month. As an example, if the first month listed is March, write March in Month 1. Be sure to use the same months for each commodity, and you can skip a month if the futures contract does not exist for all commodities.

Table 1. Futures Contract Prices and Their Use

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<thead>
<tr>
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<th>Month 1:</th>
<th>Month 2:</th>
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<tbody>
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<td>Corn</td>
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<td>Wheat</td>
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Discussion Questions:

1. Is the market for corn a Carry market or and Inverse market? Can the same be said for soybeans and wheat?

2. Based on Table 2, does it pay to store soybeans? If so, how long does the market suggest they might be stored? Is the same true for corn and wheat?

3. Based on the Month 1 prices, which commodity is the most highly valued relative to the others? Is this also true in Month 4? Why is this the case?

4. How can a producer use Table 2 to make planting decisions or storage decisions?
Storage Returns

It is November 1st, and an Indiana soybean producer has an opportunity to sell at harvest for $5.45 per bushel or forward contract @ $5.80 per bushel for April 30th delivery.

1) What are the costs of storage per bushel? Assume an opportunity cost interest rate of 8%, a physical handling storage cost of 3/4 of one cent per month, and personal property taxes of 1%.

2) How does the net price received for the cash forward contract compare to a harvest price?

Another alternative is to lock-in storage returns using futures contract hedge.

3) To lock in storage returns, what position would the soybean producer take in the futures market (long or short)?

4) If May soybean futures are currently trading at $6.00 and the historical April 30th basis is $0.17 under the May futures, should the producer use a storage hedge in lieu of forward contracting? Why or why not? Assume the costs of hedging includes a $0.01 charge for broker commissions.

Discussion Questions: How does the risk inherent in a storage hedge different from the risk of the April cash forward contract? What risks exists with cash forward contracts?