Business Management In Agriculture

Using Futures Markets

A joint project of the Cooperative Extension Service, Farm Credit and Chicago Mercantile Exchange

Purpose

To help you understand:

- Commodity exchanges
- Long and short hedging
- Hedging guidelines
- Basis
- Speculation
- Market rules and safeguards

Contract Specifications

- Product
- Quantity
- Quality
- Delivery point
- Delivery date

CME Live Hog Contract

FebSize: 30,000 lbsApr(about 130 hd)JuneQuality: No. 1, 2, 3Julybarrows/giltsAug210-240 lbsOctPeoria, IL

CBOT Wheat Contract

July Sept Dec Mar May Size: 5,000 bu. Quality: No. 2 soft red or No. 2 dark northern spring Chicago, IL

Hedging

Buying or selling a futures contract as a temporary substitute for buying or selling a commodity at some later time.

Producer Choices

Sell hog contract now

and

Sell hogs later

Packer Choices

Buy hog contract now

and

Buy hogs later

Steps In Hedging

- 1. Establish price objective
- 2. Select contract month
- 3. Estimate local hedge price

Price Objective

Break-even price

+

Fixed level of profit

Basis

Cash price

- Futures contract price
- = Basis

For 600 - 700 lb. feeders

Oklahoma City cash price

- CME Futures contract price
- = Localized basis

Steps In Hedging

- 1. Establish price objective \$44.70
- 3. Estimated local hedge price \$48.70

Established Price Objective -- \$44.70

<u>Mo.</u>	Cash	Futures	Basis
M	Expected	Sell	-0.60
A	hedge price	July LH	
R	\$48.70	\$49.30	
J	Local cash	Buy	-0.60
U	price	July LH	
L	\$42.70	<u>\$43.30</u>	
		+\$6.00	

Cash	\$42.70
Futures	<u> 6.00 </u>
Realized price	\$48.70

Established Price Objective -- \$44.70

<u>Mo.</u>	Cash	Futures	Basis
M	Expected	Sell	-0.60
A	hedge price	July LH	
R	\$48.70	\$49.30	
J	Local cash	Buy	-0.30
U	price	July LH	
L	\$44.00	<u>\$44.30</u>	
		+\$5.00	

Cash	\$44.00
Futures	<u> </u>
Realized price	\$49.00

Established Price Objective -- \$44.70

<u>Mo.</u>	Cash	<u>Futures</u>	Basis
M	Expected	Sell	-0.60
A	hedge price	July LH	
R	\$48.70	\$49.30	
J	Local cash	Buy	-0.60
U	price	July LH	
L	\$52.70	<u>\$53.30</u>	
		(\$4.00)	

Cash	\$52.70
Futures	(4.00)
Realized price	\$48.70

Hedging





Price Objective

Price of hogs minus all production costs except cost of corn.

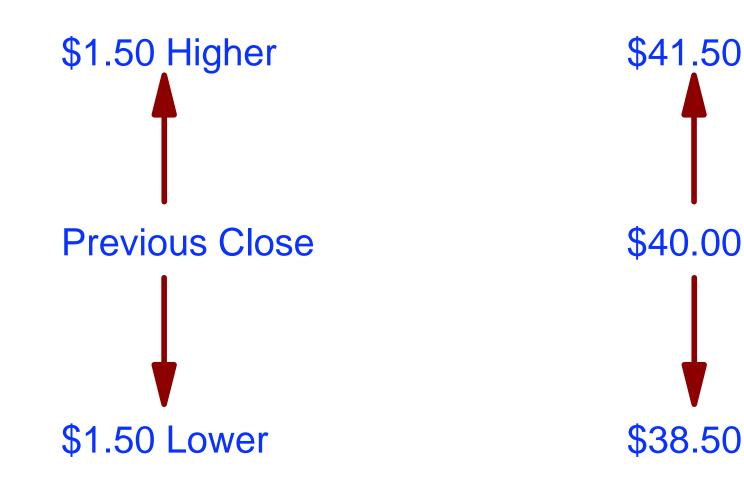
Price Objective

Price for corn that you think is reasonable.

Established Price Objective -- \$2.95

<u>Mo.</u>	<u>Cash</u>	<u>Futures</u>	Basis
A U G	Expected hedge price \$2.90	Buy Mar CBT corn \$3.10	-0.20
J A N	Local cash price \$3.00	Sell Mar CBT corn <u>\$3.20</u>	-0.20
1		(\$0.10)	
Cash			\$3.00
Futures			0.10
Realized price			\$2.90

Live Hog Contract



Security Deposits Allow:

- Trading on margin
- Use of leverage

Margin Call

Initial margin	\$1,200
Maint. margin	900
	Account balance
Wk 1 \$160 loss	\$1,040
Wk 2 \$100 loss	940
<u>Wk 3 \$100 loss</u>	840
Total \$360 loss	
Cust. margin call	\$ 360

Three-Party Agreement

