

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

Feb	Size: 30,000 lbs
Apr	(about 130 hd)
June	Quality: No. 1, 2, 3
July	barrows/gilts
Aug	210-240 lbs
Oct	
Dec	Peoria, IL

CBOT Wheat Contract

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

$$\begin{aligned} & \text{Cash price} \\ - & \text{Futures contract price} \\ = & \text{Basis} \end{aligned}$$

For 600 - 700 lb. feeders

$$\begin{aligned} & \text{Oklahoma City cash price} \\ - & \text{CME Futures contract price} \\ = & \text{Localized basis} \end{aligned}$$

Steps In Hedging

1.	Establish price objective	\$44.70
2.	Select contract month -- July	
	contract price	49.30
	Basis	<u>- 0.60</u>
3.	Estimated local hedge price	\$48.70

Established Price Objective -- \$44.70

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

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

Established Price Objective -- \$44.70

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

Cash	\$44.00
Futures	<u>5.00</u>
Realized price	\$49.00

Established Price Objective -- \$44.70

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

Cash	\$52.70
Futures	<u>(4.00)</u>
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>	<u>Basis</u>
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
		(\$0.10)	

Cash	\$3.00
Futures	<u>0.10</u>
Realized price	\$2.90

Live Hog Contract

\$1.50 Higher



Previous Close



\$1.50 Lower

\$41.50



\$40.00



\$38.50

Security Deposits Allow:

- Trading on margin
- Use of leverage

Margin Call

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

Three-Party Agreement

