

Decisive Marketing

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Bullish Markets or Train Wreck Ahead?

A wide variety of opinions exist among market analysts and others looking at the agricultural economy. Some see encouraging signs for price improvement in the grain markets. Others are still worried that low prices and economic problems may still lead to a financial “train wreck” for agriculture.

The US economic recession and slumping world economies contributed to the rapid grain/oilseed price declines from last year’s record highs. Prices recovered somewhat at year’s end, but declined again as economic worries continued and grain prices have since struggled in their attempts to recover to early January highs. Last year’s increased grain production worldwide exceeds anticipated use. Wheat and corn exports have been much slower than last year. The increased production and slower exports cause expected domestic and world carryover supplies of coarse grain and wheat to increase significantly. Fluctuating currency values and weak energy prices have also been negative influences on grain prices. The USDA continues to project lower feed use for corn and reduced soybean crush. These and other market factors when combined with high production costs suggest significant market risks along with the potential for a “financial train wreck” for agricultural producers.

In spite of the concerns, there are some positive signs emerging as well. Is the “demand destruction,” that many talked about earlier really occurring? Maybe not. Corn feed use is down from last year, but increased DDGs from ethanol production along with feeding of wheat and other feed grains accounts for much of the difference. The USDA’s total domestic corn use estimates now actually show an increase over last year, primarily due to increased ethanol production and stronger than expected feed use. Corn and wheat exports are struggling, but it appears to be more of a result of increased world grain production rather than demand destruction. In spite of poor world economic conditions, the USDA projects increased world use of wheat, corn and other feed grains over previous years. The surprisingly strong demand along with reduced corn and wheat acreage intentions for 2009, dry conditions in the southern plains, the extent of freeze damage to wheat, planting delays for spring wheat, and wet Corn Belt conditions with possible planting delays make a case for higher price potential.

Soybeans appear to be the most bullish right now. The USDA projects a tight 2008-09 carryover of only 165 million bushels. Some analysts believe soybean ending stocks will eventually decline to “pipeline” levels by the end of the marketing year. Export demand remains strong and reduced Argentine production, along with farmer tax protests, have reduced Southern Hemisphere competition. The prospective 2009 US soybean plantings are lower than many analysts expected. This

along with the strong soybean demand suggests that 2009-10 soybean supplies may be lower than what most had worried about earlier. These fundamental factors have helped push old crop (May 09) soybean futures prices into the mid \$10 range and new crop (November '09) futures prices to the mid \$9 range.

Other factors could also become important to market direction. How quickly the economy turns around and the extent of the recovery will be important. Final acreage may be different than the March intentions. Total prospective planted acres of major crops are less than was planted last year. While these may be marginal acres, there is the possibility that more acres will be planted. The acreage mix could also change. Weather and its impact on production also become more important as the growing season approaches. Various combinations of these supply, demand, price and economic factors could tip the scales toward improved price prospects or back toward a marketing train wreck.

Managing risk is essential! Marketing strategies to capture profits are likely to be more successful than holding out for higher prices. High price is difficult to define. No one knows what the highs are until they are history and prices near last year's highs seem to be very unlikely. The negative economic factors and other markets (energy, currency, stocks, etc.) could overshadow grain market fundamentals and send prices lower, which could make current prices seem high. Instead of expecting higher prices, the goal should be to recognize and capture profit opportunities.

In these uncertain markets, the challenges will be when and how to protect profits without selling too quickly or waiting too long. New crop cash bids at most Missouri locations offer some profit. However, the profit margins offered for soybeans are currently better than those for corn for most of the state's producers. For other Corn Belt states, prices may still slightly favor corn. But changing new crop soybean/corn futures price ratios (near 2.3/1) are also beginning to suggest a market shift that may favor soybeans, which might be a consideration in any last minute changes to production plans.

New crop soybean futures prices are in an uptrend, which points to higher prices. If the uptrend is broken, make sales at that point or just below chart support near \$9.00 in November soybean futures. If the uptrend continues, watch for new crop prices near their January highs of about \$10.50. Failure to penetrate these January highs should probably then trigger sales. Delay sales if November futures prices move above the January highs, but at the same time increase downside price traps to these levels to protect against a price reversal. These price objectives are examples of where to begin targeting or adding to soybean sales.

December corn futures prices have traded sideways for nearly a month in a range that is supported near \$4.11 to chart resistance at about \$4.37. Consider adding to sales if prices move through the support toward \$4.00 to at least protect a narrow margin on a portion of the crop. Delay sales and raise downside price traps if December futures prices move upward through \$4.40.

Wheat prices are also in a sideways pattern similar to corn. However, current new crop cash bids do not represent prices that offer profits over total costs. But, they do more than cover operating costs and a downside breakout from the sideways trend may suggest protecting, at least, a margin above operating costs.

How to make sales? There are no easy answers to this question either. With a decent growing season and normal production, new crop corn and soybean cash bids offer profit margins for most producers. Cash contract sales would protect these profits on the portions of the crop sold at these prices. Futures hedges would accomplish nearly the same objectives, but margin requirements could be substantial if prices increased significantly. Expensive option premiums make it difficult to

purchase at-the-money (ATM) put options for corn or soybeans. The premium costs would wipe out profit margins and out-of-the money (OTM) lower priced put options would not protect prices at profitable levels. This suggests that more complicated option strategies may be needed. A fence (buying ATM puts and selling OTM calls), a bear spread (buying ATM and selling OTM put) or other option spread strategies could be effective strategies. It is important to understand how each strategy works, the risks associated with it and be prepared for the cash requirements needed to complete the strategy.