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## Store Corn and Soybean Crops—How Long?

*Corn prices have been in a downtrend since April.* USDA projections of a record 10.961 billion bushels production, harvest time price pressure, increasing estimated 2004/05 ending stocks, and disappointing old crop exports are among the causes of the downtrend that continues to break technical support at lower price levels. The result is disappointing harvest time corn prices when compared with prices offered earlier in the season.

Will prices recover in the coming months, making storage a good alternative to harvest time sales? Market factors that could turn prices around are: anticipated strong domestic and export demand of more than 10.7 billion bushels, declining world corn supplies, and reduced Chinese export competition. Additionally, while expected to increase, projected U.S. ending stocks are not burdensome and somewhat below average. USDA's projected price range is \$2.00-\$2.40 and current prices are at or below the lower end of that range, hinting that higher prices should occur at some point.

*The corn markets are providing storage signals into next summer.* Market carries and weak harvest time basis are market signals to store corn. Deferred 2005 corn futures contracts for March, May and July all offer premiums over the December 2004 contract or market carries of about \$0.10, \$0.16 and \$0.21, respectfully. These carries will about cover storage and interest costs for on-farm corn storage and, along with seasonal basis gains, may recover commercial storage costs. However, there is no guarantee that the futures market will continue to offer these returns and, unless the carry is hedged, the price premiums may be gone when the deferred months arrive. Basis is also weakening and typically recovers after harvest and into the following spring and summer, signaling potential storage returns for basis gain. While the markets are offering storage signals and a number of market factors could result in higher prices, understand that storing unpriced corn to capture higher prices is speculation on higher prices and/or basis strengthening.

Some elevators are already offering a way to capture some limited storage returns. For example, as reported by DTN (9-16-04), one West Central Missouri elevator's cash corn bid was \$1.86. The elevator also offered a January corn bid of \$2.03. This \$0.17 gain would be offset by an estimated \$0.07 storage and interest cost for on-farm storage, producing a net storage return of about \$0.10 per bushel. Depending upon storage charges, using commercial storage would probably break even. Although January corn bids reported by DTN were limited, some of the bids from other elevators scattered across the state offered similar returns. January sales eliminate downside price risk, avoid harvest time price lows, and offer limited storage returns along with a method of managing cash sales for income tax purposes.

While making sales for January delivery would limit capturing additional price gains, participating in later price rallies could be accomplished by re-owning the corn using call options. At-the-money call option premiums for distant months' (March, May or July) corn futures contracts are competitive with storage costs into those months. A combination of strategies to capture short-term storage gains and using call options to speculate on higher prices gives up some potential basis strengthening and some of the potential price gains, but generates cash flow and reduces storage risks while keeping open the opportunity to participate in higher prices.

***Soybean prices also signal short term storage potential.*** Good early harvested soybean yield reports, expected harvest deliveries, and negative market reaction to positive news has pressured recent soybean price bids. However, declining USDA production estimates, strong domestic and export demand, along with projected 2004/05 below average ending stocks of 190 million bushels suggest opportunities for post-harvest soybean price rallies. Additionally, it appears the carry offered by January and March 2005 futures contracts, along with typical seasonal basis gains, should cover storage costs into early 2005.

***Longer term soybean storage appears more risky than longer term corn storage.*** Increased South American production is expected in 2005 along with record high world soybean ending stocks. These factors, along with the possibility of good U.S. production prospects next spring and summer, limit potential gains and increase the risks of lower soybean prices into late spring or early summer. Considering these factors, longer term storage profits do not seem likely. For those still bullish on longer term soybean prices, capturing short term storage gain with winter time cash sales and re-owning the soybeans with futures/call options appears to be a better plan than longer term storage.

## **Put Option Hindsight**

Using put options to protect prices is an effective price risk management strategy. However, these strategies nearly always look much better in the fall looking back at *what might have been* than in the spring looking ahead at *what could be*. Expensive option premiums and anticipated weak harvest time basis, along with often discounted new crop futures prices, result in a disappointing net protected price. This is especially true when comparing with old crop prices in a strong bull market. This can be illustrated by looking at one of the corn selling strategies offered in the April 16, 2004 issue of "*Decisive Marketing*."

In the mid-April example, December corn had closed at \$3.19. A \$3.20 (strike price) December corn put option could have been purchased at a premium (cost) of \$0.32. It was noted that the high cost of the premium resulted in a futures price floor of \$2.88 (\$3.20 strike price minus \$0.32 premium). Assuming a harvest time basis of minus \$0.25, the net protected price was only \$2.63—not especially attractive when old crop cash bids were \$3.00 or more!

Now look at how that put option strategy would have performed. Currently (9-16-04), December corn futures prices are about one-dollar lower, or \$2.16. Assuming the basis is minus \$0.25, the cash corn price bid is \$1.91. The premium for the \$3.20 December put option is now almost \$1.04. Since the premium paid was \$0.32, the net return on the put option is \$0.72. This results in a net price of about \$2.63 (\$1.91 cash bid plus \$0.73 put premium gain). Note that the net price would also need to be adjusted slightly to account for broker fees and other costs of the option transaction. However, the \$2.63 net price looks much better now when cash bids are

\$1.91 than it did last April when old crop bids were \$3.00 or more. This example demonstrates the effectiveness of using options, even when premiums are expensive, to protect prices in volatile markets.

## **LDPs Are Back**

Lower grain prices have resulted in corn and grain sorghum prices that are below CCC loan prices. The CCC marketing loan provisions allow using the loan or collecting the LDP (loan deficiency payment). Remember that the loan/LDP can be incorporated into marketing strategies three ways: as a price support mechanism, as price insurance, or used as a price enhancement speculative tool. It is also important to insure eligibility requirements, which include maintaining beneficial interest (title, control and risk of loss), crop quality, and government program compliance requirements are met.

**Price Support:** The LDP is intended to make up the difference when the PCP (posted county price), which is based on cash price, is below the county CCC loan price. Collecting the LDP on grain delivered and sold at harvest effectively supports the net price received at about county loan price. It is important to make sure that FSA forms (CCC-709) have been completed and signed prior to harvest.

**Price Insurance:** The market loan or LDP can serve as “price insurance.” If the grain is placed under loan, the loan can be repaid at the PCP without interest if the PCP is below loan price. This, in effect, insures loan price because when the grain is sold at lower cash prices, the net price will include the market loan gain from repaying the loan at the PCP. If the grain isn’t under loan, the LDP effectively provides price insurance at loan price because it can be collected anytime as long as the producer retains eligibility. This is sometimes referred to as using the LDP as a “free” put option, since the LDP makes up the difference between lower cash (PCP) prices and the loan (strike) price.

**Price Enhancement:** While the program was designed for price support or protection, the LDP can also be used as a speculative tool to enhance the price of stored grain. The objective of this strategy is to collect the LDP when prices are low and basis is also weak. This creates a larger LDP, since the spread between cash prices (PCP) and the loan price is greater. Then, when prices recover, the grain is sold at higher prices and the already collected LDP results in an even higher net price. It is important to understand that claiming the LDP and storing the grain is speculative and eliminates the price protection features of the program. If prices decline after the LDP is claimed, the net price can be less than loan price.