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## Grain Marketing Alternatives

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## GRAIN MARKETING ALTERNATIVES

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### CORN

Some farmers have been able to plant their corn and beans and want to protect the current price but not lose upside potential in case the weather rally continues. A good strategy would include selling up to one-third of expected production using a cash forward contract or a hedge (sell futures) and settle for the current price. Another one-third or more could be sold with a cash contract or hedge and then buy a call option for at least the same amount of bushels. If the price goes higher during the growing season, the call can be sold at a profit and the contract can be held for downside price protection until harvest. The remaining one-third of expected production could be left unpriced until harvest and then sold or stored. If a rally does occur later in the growing season, pushing corn futures above three dollars, the final one-third could be priced at that time rather than waiting for harvest. This would also be a good time to offset the call(s) from the second one-third of production.

If your local new crop bids reflect a wider than normal basis for harvest time delivery, a hedge-to-arrive contract could be used rather than the cash forward contract in these strategies. With this alternative, the farmer locks in a futures price with the elevator but does not set basis until later when it hopefully becomes more favorable. When the basis is fixed, the contract becomes a cash forward contract. This alternative can be used with call options to keep the profit potential from even higher rallies available.

The next question is which call option to buy. When futures prices are volatile, option premiums are quite high so buying a shorter term option, like a September rather than a December, will help to keep the premium lower and still provide profit potential from a growing season rally. A frost market rally would be lost as the September option expires in August. A second way to reduce the call premium is to buy a call with a higher

strike price than the current underlying futures contract. This is called an out-of-the-money call. If price increases a small amount, say 10-15¢, the buyer would not profit from the call option, but if price rallies 30-50¢ on a drought or frost rally, the buyer would profit from most of the rally. If price decreases below the strike price, the option premium simply becomes another cost of doing business.

### SOYBEANS

Current soybean prices have rallied on the thought of prevented planting. This may be a good time to price up to one half of expected production because expectations are for large acreage swings from wheat, oats and barley to oilseeds. Acreage swings in S.D. alone could easily involve one million more acres of oilseed than were reported as intended plantings in the March report. Corn planting in much of the corn belt is behind normal and additional acres may swing to soybeans in these states.

This leads to the potential for very large soybean and sunflower production in 1995. The futures market could very quickly decline 50-75¢ per bushel for soybeans and 3-4¢ per pound for soybean oil. New crop sunflower bids could drop below the loan rate.

Cash forward contracts and futures hedges offer prices nearly one dollar above last year's harvest time prices. At elevators where managers are taking too much protection (wide basis) on forward bids, the producer can request a hedge-to-arrive bid which locks in the futures price with basis to be set at a later date (selected by producer) before delivery at harvest time.

If you want to protect a minimum price and still be able to take a higher price at harvest should a short U.S. crop occur, buy a put option. Currently, put option premiums are quite expensive due to the market volatility. If you wish to cheapen up the option premium paid, a fence strategy is possible. With this strategy, a put option is bought at a strike price out-of-the-money and a call option is sold at a higher strike price but with a premium collected that is equal to, or nearly equal to, the put premium paid. What is forfeited is the potential to receive a price higher than the call option strike price. Also, margining is required when an option is sold.



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A synthetic put is another alternative if you think there is still a good chance for a summer soybean price rally. Begin by selling a percentage of expected production using a futures hedge, cash forward contract, or hedge-to-arrive contract. Then, buy a call option for at least as many bushels (options contracts are either 1000 or 5000 bushels). If the price rally occurs, sell the call for a profit and hold the contract until harvest for downside price protection. If there is no rally, the option is allowed to expire, and the premium paid becomes another cost of doing business.

**SUNFLOWERS**

What will sunflower prices be this fall? This question is being asked by many producers as they switch more small grain acres to sunflowers and as corn belt producers switch to more soybeans. Downside price risk is large, if a good oilseed harvest materializes in 1995. Demand is strong, but it can't offset large increases in production.

Farmers should consider cash forward contracts on expected sunflower production not covered by the loan program. Up to one-half of expected production could be priced now with even more priced on a summer rally should one occur.

There is no futures contract for hedging sunflowers, but the soybean oil futures contract has been used to successfully cross-hedge sunflowers. To cross-hedge, sell soybean oil futures at the Chicago Board of Trade -CBOT- (60,000 pounds) or Mid American Exchange (30,000 pounds). A CBOT contract prices 100 acres at 1500 pounds per acre.

The historical relationship between soybean oil and sunflowers suggests that sunflower price is around

42% of soyoil futures price. So the current \$26 per hundredweight price of soybean oil would lead to a hedged price of \$10.90 per hundredweight of sunflower at Enderlin, ND.

The premium cost of buying a soyoil put option is currently around \$.60 per hundredweight of sunflower, but it does set a minimum price of around \$9.80 per hundredweight. Even with a wider than expected basis, a minimum price of \$9.50 per hundredweight would be protected. If price were to increase, the option would expire and the premium would be another cost of doing business.

For sunflowers sold on a cash forward contract or hedged on the soyoil futures, a ceiling price is set. To regain the upward price potential from a summer rally, a soybean oil call option could be purchased. If the price of soyoil increases due to a summer weather problem or an unexpected foreign sale, sell the option and take the premium money. If there is no summer rally, the option expires and the premium paid is simply a business cost.

Whatever is done, write a marketing plan and be ready to execute it when your price objectives are met.

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**ECONOMICS COMMENTATOR**

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