



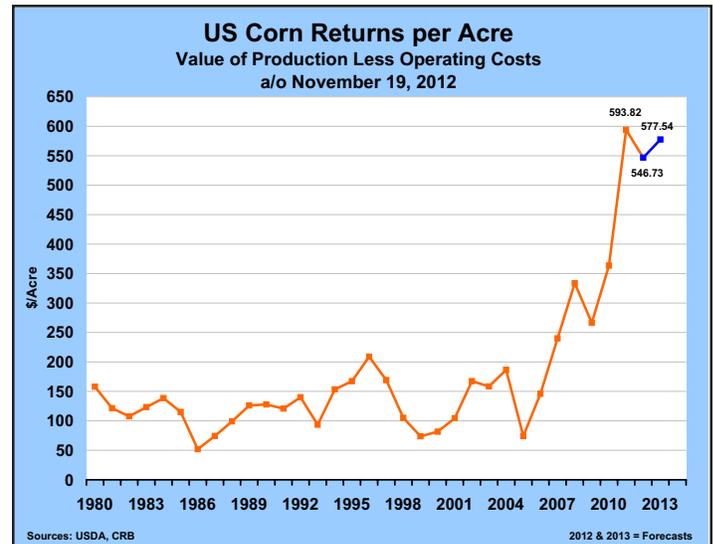
Producer Hedge Strategies for Corn and Soybeans

November 19, 2012

There seems to be significant risk to the downside for 2013 corn and soybean prices if South American weather is favorable and if the US drought does not reappear in the spring. Given that current new crop prices offer historically high returns for both crops and that concerns for the economy are mounting, corn and soybean producers should consider entering new crop hedges earlier than normal.

CORN: Producers are reluctant to sell \$6.00 corn when old crop prices are well above \$7.00 and there is so much uncertainty for the next season. We have consistently heard complaints that leveraged option hedge strategies are too complicated or require too much margin and that “good marketing” is just a matter of “good timing.” We disagree. Leveraged put strategies can actually increase effective prices in years of downtrending markets. And in contrast to forward contracts, leveraged put strategies could allow producers to capture higher prices in 2013 if South American or US weather is not ideal. Ideal weather has been priced into the market on the recent break.

Producers also well aware that yield per acre, as well as price, are a key determinant of profitability. Our studies show that corn producers might make more money with December 2013 corn priced \$6.15 per bushel than they did with the old crop priced at \$7.32 if it means they are achieving better yields. In light of this, we would strongly encourage corn producers to consider any



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Futures Analysis & Forecasting

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type of hedging strategy that protects at least some of the high profitability potential for the 2013 crop year. The enclosed charts show historically high profit per acre given average fixed and variable costs. The main fixed cost is land. Please note that \$6.15 for December 2013 Corn results in a higher return per acre than \$7.32 for old crop corn.

Producer Hedge Strategy - Preferred

Hedgers might consider the following type of hedge as a base position for the November 15 to March 15 timeframe:

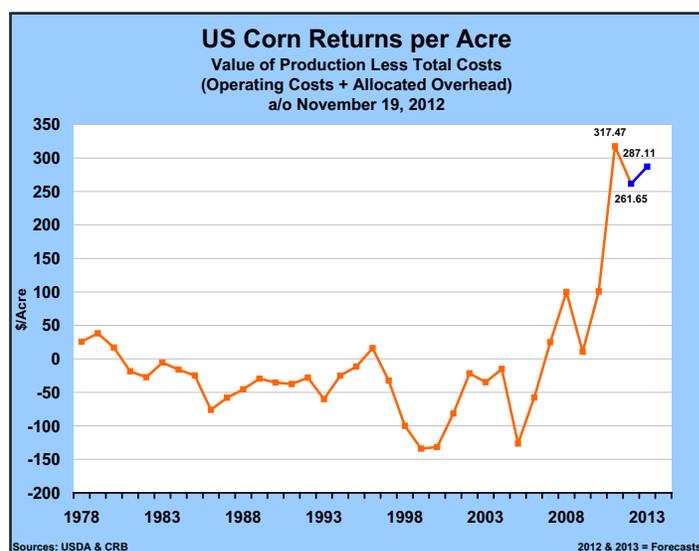
Sell 1 December 2013 Corn \$6.00 Put at 58 cents, buy 5 of the December 2013 Corn \$5.00 Puts for 17 cents each, and sell 1 December 2013 Corn \$7.50 Call at 18 cents. The net cost for the entire spread is 9 cents.

If in 120 days December 2013 Corn drops \$1.00 per bushel to \$5.02, we would expect the \$5.00 Puts to be valued around 39 cents, the \$6.00 Puts to be up around \$1.08 $\frac{3}{4}$ and the \$7.50 Calls to be down to 1 $\frac{1}{2}$ cents. As a result, the spread would be valued at 84 $\frac{3}{4}$ cents. The net gain of 75 $\frac{3}{4}$ cents would mostly offset the \$1.00 break in futures, and the hedger would have an effective December Corn price of \$5.77 $\frac{3}{4}$.*

If in 120 days December 2013 Corn has dropped \$2.00 per bushel to \$4.02, the \$5.00 Puts should be valued at around \$1.04, the \$6.00 Puts at \$1.98 $\frac{1}{4}$, and the \$7.50 Calls at $\frac{1}{4}$ cent. As a result, the spread would be valued at \$3.21 $\frac{1}{2}$. The net gain of \$3.12 $\frac{1}{2}$ would more than offset the \$2.00 break in the futures, and the hedger would have an effective December Corn price of \$7.14 $\frac{1}{2}$.*

The same producer could have sold December 2013 Corn at \$6.02, and they would have been protected on a \$2.00 break. The leveraged hedge position allows for a higher effective price. The producer who sells futures or forward contracts has set their hedge price “in stone” and will not be able to take advantage of any rally into the spring.

If in 120 days December 2013 Corn has rallied 50 cents per bushel to \$6.52, the \$5.00 Puts should be valued at around 4 $\frac{3}{4}$ cents, the \$6.00 Puts near 28 cents, and the \$7.50 Calls at 22 cents. As a result, the spread, which was established at a premium paid of 9 cents, will be valued at negative 26 $\frac{1}{4}$ cents for a net loss on the entire hedge position of 35 $\frac{1}{4}$ cents. In this scenario the hedger will have an effective December Corn price of \$6.16 $\frac{3}{4}$. While not capturing the entire rally, this position is still better than if the hedger had locked in a price of \$6.02.*



If in 120 days December 2013 Corn has rallied \$1.00 to \$7.02, the \$5.00 Puts should be valued near 2 $\frac{1}{4}$ cents, the \$6.00 Puts near 16 cents, and the \$7.50 Calls near 38 $\frac{3}{4}$ cents. As a result, the spread will be valued at negative 43 $\frac{1}{2}$ cents, for a net loss on the entire hedge position of 52 $\frac{1}{2}$ cents. In this scenario the hedger will have an effective December Corn price of \$6.49 $\frac{1}{2}$. While not capturing the entire rally, this position is still better than if the hedger had locked in a price of \$6.02.*

Remember that while these are results are for the next 120 days, hedgers will be able to adjust their strategies for later in the season. If corn breaks \$2.00 into the planting season, the hedger will be in a position to sell out of 3 or 4 of the \$5.00 Puts and also lift the short \$7.50 Call. If the market rallies \$1.00, the hedger can lift the short \$6.00 Put for an approximate 42-cent gain. The hedger could hold the remaining long puts as protection against downside risk in the 250-day period from March 15 to November 22, 2013.

This hedge allows for some upside gain for the producer, but it also provides a tool for achieving a better price on a sharp break into the planting season. The flexibility and leverage of this type of hedge appear to more than offset the complexity. We would strongly encourage producers to learn to use option strategies to enhance their marketing efforts.

Producer Hedge Strategy - Simple

A simpler hedge for new crop corn producers would be as follows:

Buy the December 2013 Corn \$5.80 Put for 36 cents and sell

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the December 2013 Corn \$7.70 Call for 18 cents. For 18 cents on the table, the hedger can set an effective hedge window of \$5.62 to \$7.52 for the new crop season.

If in 120 days December Corn rallies \$1.00 to \$7.19 per bushel, the \$5.80 Puts should be valued near 9 ½ cents, and the \$7.70 Calls should be trading around 39 ¾ cents. This would amount to a 48 ¼ cent loss for the hedge into the planting season, which will be offset by the \$1.00 gain in the cash position.*

SOYBEANS: For soybeans, we believe a more direct approach may be in order. **We suggest using a short-term bounce to sell November Soybeans in the \$12.98 to \$13.05 ½ zone.** Once that base position is established, consider using “hedge the hedge” strategies that will allow the producer to improve on the selling price if the market were to see a significant resumption of the uptrend. In this report we are looking at hedges that we believe will work well as protection for the next 120 days, into the planting-decision period.

Two option strategies to consider on top of the base short futures position include:

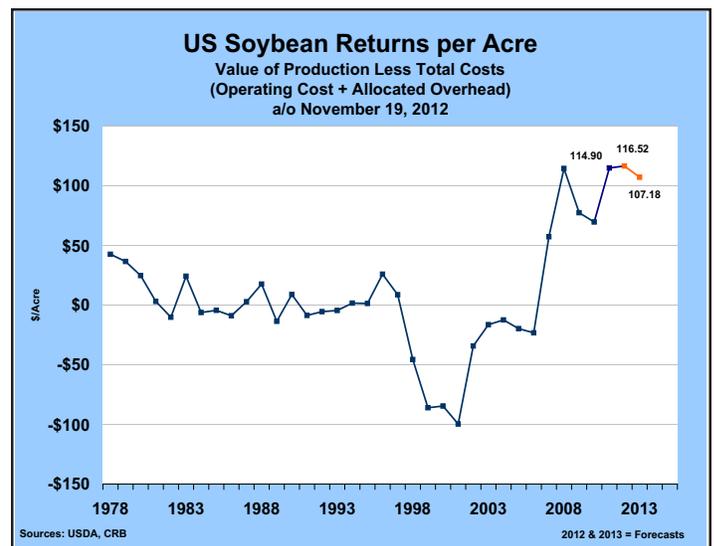
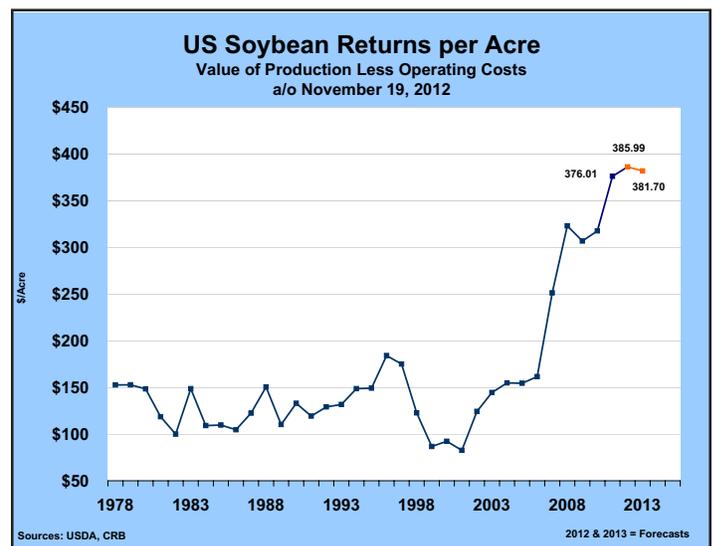
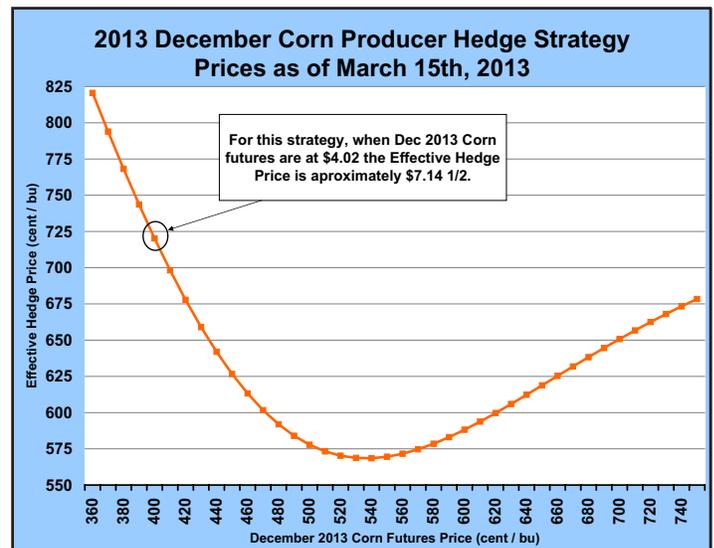
1) Bull Call Spread: Buy the November 2013 Soybean \$13.00 Call and sell the November 2013 \$15.00 Call on a spread for a net premium paid of 51 cents per bushel.

The maximum gain on this spread is \$1.49. “Just in case” South American weather turns poor, the spread should offset some of the hedge losses on the short futures position. If the market is trading near the current price level after 120 days, both calls should deteriorate, but the spread itself should only lose about 3-4 cents per bushel.*

2) Buy 2 March 2013 Soybean \$14.60 calls at 30 cents each.

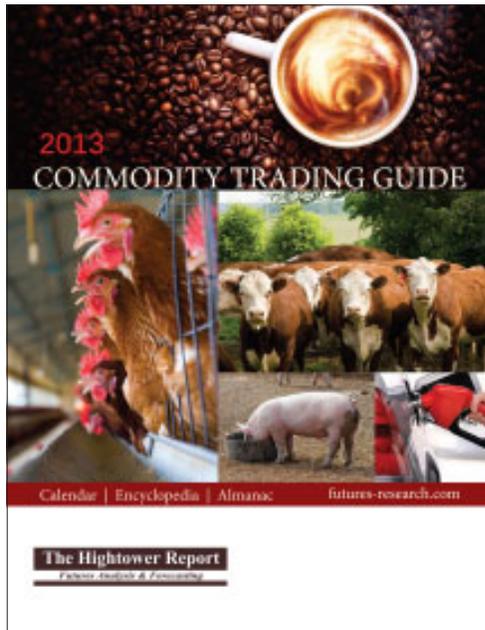
Initially, this position will partially offset a weather-induced rally in soybeans. On a strong rally the hedger will be in a position to lift one or both of the calls. Once again, the “hedge of the hedge” protection lasts only for the next 95 days. If in the next 60 days March Soybeans recover half of the losses that have seen since the summer peak, the calls will be valued around 94 cents. The \$1.28 gain should help offset most if not all of a similar rally in November 2013 Soybeans. March Soybeans were trading at a \$3.30 premium to November in early September; that premium now is near \$1.03.*

**Option values are based on pricing models and are not guaranteed.*



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