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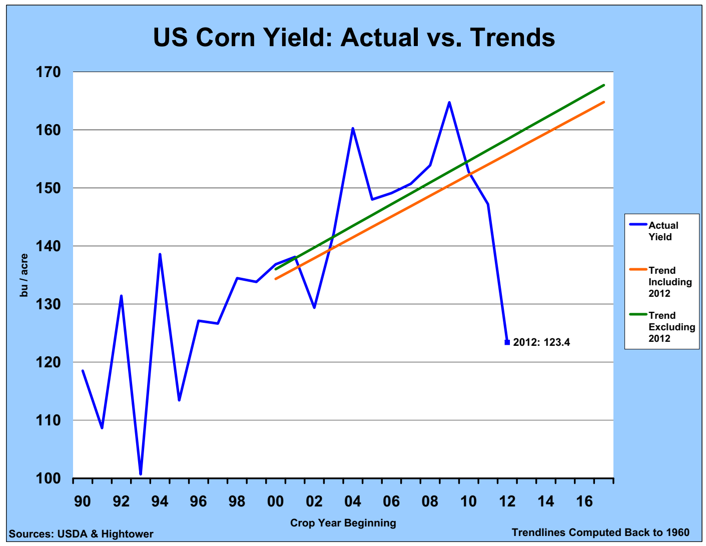
Corn Producers: Use Volatility Hedges to Manage Historic Price Swings!

January 28, 2013

As global markets start out 2013, few commodities have a more uncertain outlook than corn. In the wake of last year's rally to a multi-decade high with planted acreage of more than 97 million acres, many analysts are projecting that 2013 could see planted acreage in excess of 99 million acres. There has been wild variation in moisture levels for key US production areas. Many regions in the Western Corn Belt have been under drought, while portions of the Eastern Corn Belt have had plentiful moisture during the fall and winter. When you factor in uncertain South American production with volatile feed and ethanol demand, ending stocks for the 2013/14 crop have as much potential for climbing above 3 billion bushels as for falling below 1 billion bushels.



With all of those factors likely to be in play, the price of December Corn is quiet capable of moving several dollars in either direction by the end of the year. It will be difficult for either speculators or hedgers to maintain any single trading bias over the course of the upcoming season. It may prove to be much more beneficial to go looking for volatility during 2013, as there is little chance that corn prices are going to stay subdued and remain within a tight trading range. Current new crop corn prices offer near-record profitability for producers, which is one of the key reasons we expect to see a sharp increase in planted acreage this year.

This Special Report was prepared by

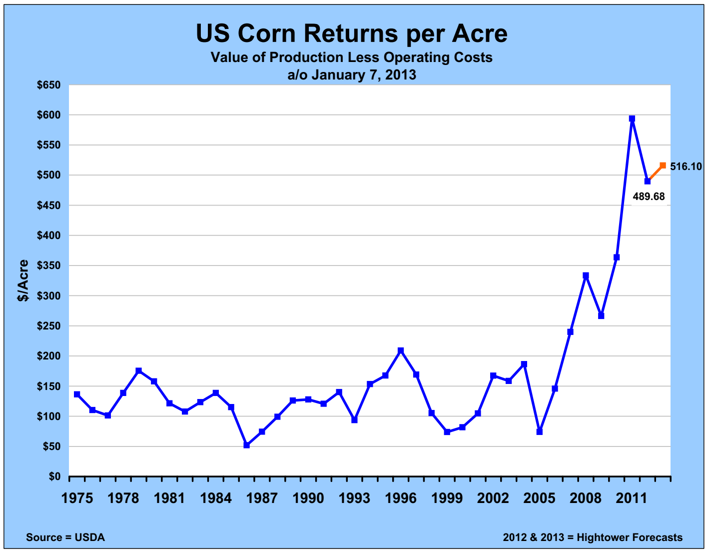
The Hightower Report

Futures Analysis & Forecasting

As we stated above, current forecasts call for corn planted area to reach 99 million acres for the 2013/14 season. If weather conditions stay close to normal and the crop reaches a simple trendline yield of 157.6 bushels-per-acre yield (based on data from 1960 to present), this would bring total US production to 14.27 billion bushels, 3.009 billion bushels above the estimated usage for 2012/13. Keep in mind that at their Outlook Conference in February 2012, the USDA projected a corn yield for 2013/14 of 164.0 per bushels-per-acre if weather conditions are normal.

The enclosed table shows projections of ending stocks based on various yield estimates. (For our estimates, we increased corn usage for 2013/14 by 1.4 billion bushels, so we are already assuming a very strong demand outlook.) A trendline yield would result in with an ending stocks forecast of 2.3 billion bushels and a stocks/usage ratio of 18.2%. This is up sharply from 2012/13, for which the USDA currently estimating ending stocks at 602 million bushels and the stocks/use ratio at 5.3%. A 164.0 yield this summer, which is what the USDA was forecasting a year ago, would result in ending stocks at nearly 3 billion bushels and a stocks/use ratio of 22%, a 21-year high.

USDA SUPPLY/DEMAND US CORN	06-07	07-08	08-09	09-10	Jan USDA 10-11	Jan USDA 11-12	Jan USDA 12-13	2013/14 Projections ------ Yield Estimates ------ Low	Trend	High
Planted Area (M Acres)	78.3	93.5	86.0	86.4	88.2	91.9	97.2	99.0	99.0	99.0
Harvested Area (Acres)	70.6	86.5	78.6	79.5	81.4	84.0	87.4	90.6	90.6	90.6
Yield (Bu/Acre)	149.1	150.7	153.9	164.7	152.8	147.2	123.4	149.7	157.6	164.0
Beginning Stocks (M Bu)	1,967	1,304	1,624	1,673	1,708	1,128	989	602	602	602
Production	10,531	13,038	12,092	13,092	12,447	12,360	10,780	13,561	14,276	14,856
Imports	12	20	14	8	28	29	100	100	100	100
Supply, Total	12,510	14,362	13,729	14,774	14,182	13,516	11,869	14,263	14,978	15,558
Feed & Residual	5,540	5,858	5,182	5,125	4,795	4,548	4,450	5,000	5,000	5,000
Food, Seed & Industry	3,541	4,442	5,025	5,961	6,426	6,437	5,867	6,267	6,267	6,267
Ethanol for Fuel	2,119	3,049	3,709	4,591	5,019	5,011	4,500	4,900	4,900	4,900
Domestic Total	9,081	10,300	10,207	11,086	11,221	10,985	10,317	11,267	11,267	11,267
Total Exports	2,125	2,437	1,849	1,980	1,834	1,543	950	1,400	1,400	1,400
Use, Total	11,207	12,737	12,056	13,066	13,055	12,527	11,267	12,667	12,667	12,667
Ending Stocks	1,304	1,624	1,673	1,708	1,128	989	602	1,596	2,311	2,891
Stocks/Use Ratio	11.6%	12.8%	13.9%	13.1%	8.6%	7.9%	5.3%	12.6%	18.2%	22.8%



The USDA Outlook Conference last year pegged ending stocks for 2012/13 at 1.6 billion bushels, and this helped push December 2012 Corn to a low of $5.06 by June 15th, 2012, before the drought hit. This year's Outlook Conference is likely to project an even higher ending stocks estimate than last year.

The forecasts shown in the table on page 2 illustrate that December 2013 Corn is already holding a very high weather premium. Even if yield comes in 5% below the trendline at 149.7 bushels-per-acre, ending stocks will still jump to 1.59 billion bushels with a stocks/usage ratio of 12.6%.

In several issues of our Weekly Market Letter, from November, December and January, and in Special Reports from late 2012, we have presented producer hedge strategies that provide leveraged downside protection while leaving some upside potential. At this point, we strongly recommend that producers take action to protect against the potential volatility ahead.

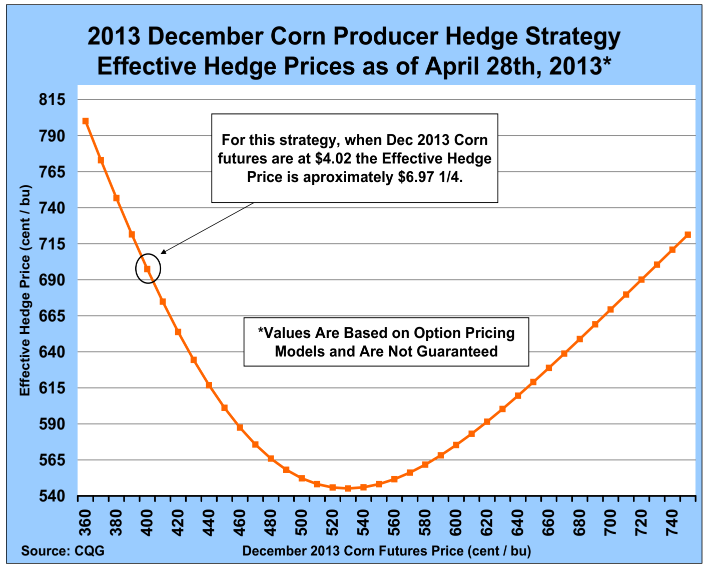
Here are some hedge ideas for producers:

1) At the very least, producers should buy some puts to protect the considerable profitability for producing corn.

2) In order to position for a potential spring weather rally, producers could consider forward contracting a portion of their new crop corn, then selling 1 July Corn futures and buying 2 July $7.30 calls. A price break into the planting season could help pay for a good portion of the premium spent on the calls.

3) More experienced option hedgers could consider selling 1 December Corn $6.00 put near 60 cents and then buying 5 December Corn $5.00 puts at 17 cents each. At a net cost of 25 cents, the spread will protect the producer on a sharp break into the planting season while leaving the upside open. The hedger can also consider selling a December Corn $6.70 call for 25 cents as an additional leg to this strategy. This would limit the upside, but it would also pull the net cost of the spread down to 0 (zero) cents. (See our November Special Report for a full explanation of this type of hedge.)

If December corn drops $1.37 to the $4.50 level over the next 90 days, the 5 by 1 spread, for which the producer paid 25 cents, should be trading near $1.79. This is a gain of $1.54 on the hedge. If December corn drops by $1.87 down to the $4.00 level during the next 90 days, the 5 by 1 spread should be trading near $3.25. This would represent a gain of $3.00 on the hedge. *



The enclosed chart illustrates what the effective hedge price would be at various price levels for December corn. These are values as of April 28th, about 90 days from now. Clearly, this is a hedge that will benefit from volatility over the next 90 days. If corn breaks to $4.00, the effective hedge price will be around $7.00 per bushel, as the downside leverage of the hedge will kick in. The upside is wide open except for the 25 cents that was paid to establish the hedge.

The benefits of this volatility hedge will be felt if December corn makes a significant move in either direction. The downside is leveraged, so the producer may be overhedged on a significant break. The other benefit is a relative low cost relative to simply buying an at-the-money put, which is currently valued near 52 cents.

A drawback to the hedge would occur if the market were to fail to show much volatility over the next three months and December corn simply drifted lower. But given the current fundamental setup, either a severe drought in the Western Corn Belt or just "normal" weather could result in substantial price volatility. Keep in mind that for the past five years the average range for December corn in the 15 months prior to expiration has been $3.05. Since September 20th, December 2013 corn has traded in a range of only 77 cents.

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

Trading futures contracts and commodity options involves substantial risk of loss, and thus is not appropriate for all investors. Investors should carefully consider the inherent risks of such an investment in light of their financial condition.