How to Prepare for What’s Ahead in the Ag Markets

Chip Flory
Editorial Director – Pro Farmer
Host – Market Rally
A look back to look ahead

• 1988
  – Recovery from farm crisis begins
• 1991
  – “How can we help them survive?”
• 1998
  – Keen focus on business side of agriculture
• 2005
  – Here comes ethanol
• 2008
  – “Can we grow enough corn?” (’07-’08, 2.4BB; ’07 93.5m/ac, ’08 86m/ac.; 650mb moves from exports to ethanol)
• 2011
  – “How can we help them hold onto what they’ve got?”
• 2016
  – The industry was supposed to change
Is ag-biz really changing?

• No
  – It’s still a S&D business
  – Weather still matters
    • A LOT!!

• YES!
  – Markets ‘bigger’ than ever
    – Bigger risk!
    – Bigger reward?

• No
  – There are still ‘rules’ to follow
    – Margin-driven
    – Long-term trends

• YES!
  – Crop and margin management
    – ‘Chemphobia’
    – Distrust of science
    – So MUCH info
    – So MUCH data
Don’t lose track of biggest trend!

9 billion population by 2050
The mega-trend

• China
  – 1.36 billion
• Indonesia
  – 250 million
• Bangladesh
  – 157 million
• The Philippines
  – 100 million
• Vietnam
  – 90 million
• South Korea
  – 50 million
• Malaysia
  – 30 million

More than 2.2 billion people in countries with growing economies.
Consumers are moving up into the middle class.

With limited resources!

1.937 BILLION
The challenge –

• Can the world’s farmers keep up and produce enough food to meet expanding demand for food?
  – China – growing it’s hog herd
  – India – expanding its diet
  – Cuba – could be a great market for U.S. rice/pork
  – SE Asia – The divide between poor/middle class is expanding as middle class expands

• Can we keep up?
Global Wheat Crop/Use

Wheat Production

Wheat Consumption

2014-15
2015-16
2016-17
Global Coarse Grain Crop/Use

Coarse Grain Production

Coarse Grain Consumption

2014-15

2015-16

2016-17
Global Corn Crop/Use

- 2014-15: Corn Production 1010, Corn Consumption 980
- 2015-16: Corn Production 970, Corn Consumption 980
- 2016-17: Corn Production 1010, Corn Consumption 1030

Legend:
- Corn Production
- Corn Consumption
Global Rice Crop/Use

- **Rice Production**
- **Rice Consumption**

<table>
<thead>
<tr>
<th>Year</th>
<th>Rice Production</th>
<th>Rice Consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014-15</td>
<td>478</td>
<td>478</td>
</tr>
<tr>
<td>2015-16</td>
<td>470</td>
<td>474</td>
</tr>
<tr>
<td>2016-17</td>
<td>482</td>
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</table>
Global Soybean Crop/Use

Soybean Production
Soybean Consumption

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Global ‘All’ Crop/Use

2014-15
2015-16
2016-17

All Crop
All Consumption
We can keep up!

• But that doesn’t mean we can keep up in an environment in which demand is unrestricted.
  – Technology/management matters.
  – *Price is the “restrictor plate” of the commodity world.*
Rising to the marketing challenge

• Your RISK level is always 100%!
  – Price risk on unsold grain in the bin, grain that’s growing in the field and animals on feed.
  – Opportunity risk on grain and livestock that’s already sold.
Rising to the marketing challenge

- Aggressive vs. Conservative Marketers
  - Cash-only marketers are aggressive. They have just one shot to get it right with no way of managing opportunity risk.
  - Hedgers are conservative and maintain flexibility by blending futures and options into their cash-marketing strategies to constantly balance risk.
Risk is a good thing!

- Specifically, the right amount of risk at the right time is a good thing.
- If you eliminate all risk, you eliminate all potential reward.
  - Selling 100% of production at breakeven just to prevent losses removes all potential to profit.
- The greater the risk, the greater the potential reward.
  - Holding an entire crop in the bin until the next growing season could result in windfall profits, or result in business-threatening losses!
Rising to the marketing challenge

• Things you must know to make a smart marketing decision:
  – Production costs
    • Aggressive or defensive strategy?
  – Basis history
    • Lock in basis or leave basis open?
  – Bullish/Bearish
    • Check info sources, fundamentals, seasonals, charts and psychology of market.
Rising to the marketing challenge

• Discipline vs. flexibility:
  – Be disciplined when...
    • Doing basis analysis: Time frame, current offering vs. 3- or 5-year average.
    • Selecting a marketing tool: Always start with basis analysis to pick the right marketing tool.
  – Be flexible when...
    • Considering crop size (supply) and usage (demand).
Rising to the marketing challenge

- **In your marketing tool box**
  - Cash sale into spot market
  - Cash forward contract
  - Basis contract
  - Sell cash and buy futures
  - Sell cash and buy call option
  - Minimum Price Contract
  - Offensive hedge
  - Defensive (selective) hedge
  - Hedge-to-arrive
  - Purchase of put option
  - Deferred price contract
  - Do nothing
Rising to the marketing challenge

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Cash-only market strategies to use when basis is strong.
Rising to the marketing challenge

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*Cash-only market strategies to use when basis is weak.*
Rising to the marketing challenge

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*Hedger strategies to use when basis is strong.*
Rising to the marketing challenge

• **In your marketing tool box**

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*Hedger strategies to use when basis is weak.*
Rising to the marketing challenge

• That’s a “sorting” of strategies by basis strength – now add your market attitude:
  
  – *Are you bullish or bearish?*
**Rising to the marketing challenge**

### Stronger-than-normal basis

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<th>Bullish price outlook</th>
<th>Bearish price outlook</th>
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<tbody>
<tr>
<td>When basis is stronger than normal and your outlook for futures prices is bullish</td>
<td>When basis is stronger than normal and your outlook for futures prices is bearish</td>
</tr>
<tr>
<td>— Basis Contract —</td>
<td>— Minimum Price Contract —</td>
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</table>
| — Sell cash, buy-back in futures — | :use when basis is strong and price outlook is uncertain:
| — Sell cash, buy-back with call option — | — Spot-market cash sale — |
| — Do Nothing — | — Forward-contract cash sale — |

### Weaker-than-normal basis

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Rising to the marketing challenge

• Each year is a challenge
• Each year is an opportunity

*Use the right tool at the right time to give yourself the greatest opportunity to succeed!*
Questions?

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