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NebGuide

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How to Evaluate Grain Pricing Opportunities

This is the last in a series of six NebGuides on agricultural options and discusses "homework" needed to evaluate pricing opportunities.

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The market is an ever changing dynamic force. While we recognize this, we also realize that to do a good job of marketing, we must be able to evaluate our pricing opportunities. We must be able to evaluate what the market is offering quickly and efficiently. Evaluating pricing opportunities comes from time spent doing homework throughout the year. If we have done this homework, we can listen to the grain market reports (Chicago futures) on the radio and quickly evaluate what will be the net price received.

Examples of basic homework include 1) estimated cost of production, 2) storage costs, and 3) local historical basis differentials, and outlook. In evaluating pricing strategies, we often avoid outlook because of its uncertainty. But, we must recognize outlook carries tremendous weight when a decision is made.

Producers tend to base outlook decisions on present conditions and not on what they project will happen in the future.

Evaluating pricing opportunities requires that we look not only at present prices, but also that we determine what the net return would be by translating future price offerings to net take- home pay.

What pricing opportunities exist for producers? We must be able, on any given day, to compare price offered by 1) present cash price, 2) government program price, and 3) futures contracts, and opportunity of pricing through livestock feeding.

One of the easier ways to do this is with a simplified marketing alternatives worksheet.

After going through this worksheet, producers will generally find they have mentally and physically developed a marketing plan.

The most difficult part of the worksheet is the last line--**Outlook**. We must form an opinion which is supported by good reasoning of what prices are going to do. Outlook becomes extremely important in determining which pricing alternatives we choose or which combination we choose. For example, if we wish to protect a price but feel the market may rise, an option contract may net us less than following the market upward and placing in "stops" to insure a hedged position for our crop. Or, if we determine a downtrending outlook, we might decide to enter the government program thereby insuring government loan prices for the crop (insurance).

Using the government program, the producer is assured of a guaranteed price, yet has the opportunity to take advantage of any dramatic price increase above the target price. Another example might be a decision to hedge rather than use a cash contract. If producers are hailed out, they can easily offset their position in the futures market and thereby remove any obligation to deliver grain to the elevator.

As previous examples indicate, the worksheet is a continuously changing document that must be updated and changed throughout the year. Once the preliminary homework has been computed (e.g., historical cash prices retrieved, basis pattern developed, etc.), the marketing alternatives worksheet can be worked out in the dust of the tractor cab while listening to the radio.

Conclusion

Today's producer has the opportunity to utilize a variety of different marketing strategies. Determining which alternative or combination of alternatives will generate the highest return may appear to be a monumental task. In addition, market forces change and thus a producer's optimum marketing strategy changes each crop year. Determining a marketing plan need not be an imposing task. By using the marketing alternatives worksheet, a producer can determine or at least estimate net returns for each alternative. The worksheet examines these marketing alternatives:

1. Cash sale.
2. Government program.
3. Futures market hedge.
4. Contract sales.
5. Options contract.
6. Livestock feeding.

Current Situation

Date_____

Commodity_____

1. Cash sale (local price) _____

2. Government programs

	1986	1987
Loan rate	_____	_____

Storage payment
26 1/2 cents per bu. per year _____

3. Hedge in future market

Chicago Board of Trade

	Futures month	Less estimate basis	=		Less storage	Less lost interest	Estimate of actual price
December	_____	_____	=	_____	_____	_____	_____
March	_____	_____	=	_____	_____	_____	_____
May	_____	_____	=	_____	_____	_____	_____
July	_____	_____	=	_____	_____	_____	_____
September	_____	_____	=	_____	_____	_____	_____
December	_____	_____	=	_____	_____	_____	_____

4. Contract sales _____

a. Usually 3-5 cents per bushel less than hedging alternative

5. Options market

Month (strike price) minus premium minus broker fees = net price

Month _____ Strike price(_____)-premium(_____)-Broker fees (_____)=net price(_____)

6. Livestock feed

Projected cost Yearling steer	Project cost Corn	Estimated Slaughter Price Fall	Estimated Slaughter Price Summer
_____	_____	_____	_____
Steer Calf			
_____	_____	_____	_____
Sow & Two Litters to 225 lb			
_____	_____	_____	_____

7. Outlook _____

AGRICULTURAL GRAIN OPTIONS

This series includes the following NebGuides which may be obtained at your local Cooperative Extension office.

- *G85-768, Basic Terminology for Understanding Grain Options*
- *G85-769, Options Contract Specifications on grain FuturesContracts*
- *G85-770, An Introduction to Grain Options on Futures Contracts*
- *G85-771, Evaluating Grain Options Versus Futures Contracts*
- *G85-772, Using Grain Options to Follow a Rising Market*
- *G85-773, How to Evaluate Grain Pricing Opportunities*

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