

Bruce Watson



GRAIN GROWER AND
2009 NUFFIELD SCHOLAR



Commodity Price Risk Management



**DARE TO BE
AVERAGE!**

What Drove the Increase in Global Grain Prices?

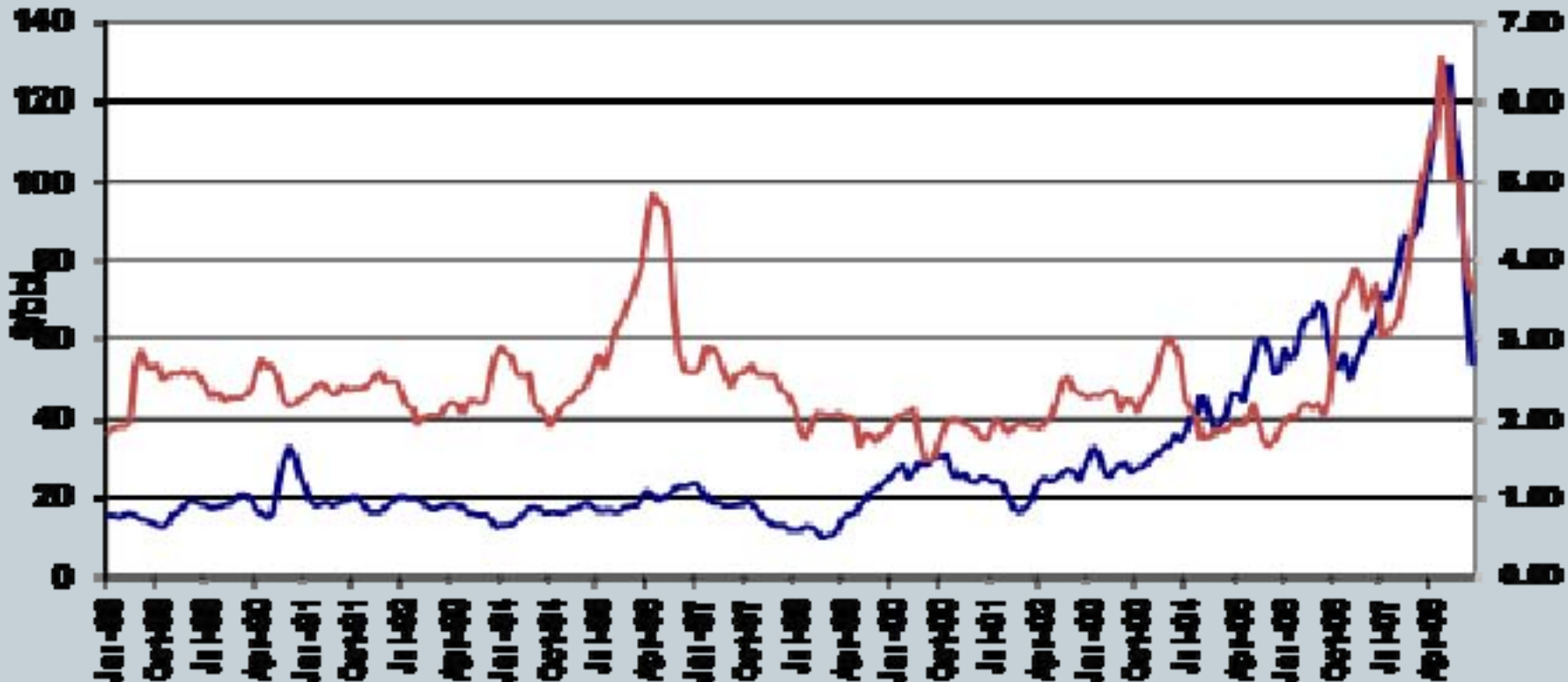


- Increasing demand from developing countries and supply shocks, coupled with government trade policies
- The increasing correlation between corn and oil
- Rapid \$US depreciation
- Behavioural impacts (and herd behaviour) on markets, linked to speculative capital inflows into commodity markets

Crude/Corn Relationship



— crude oil price — corn price



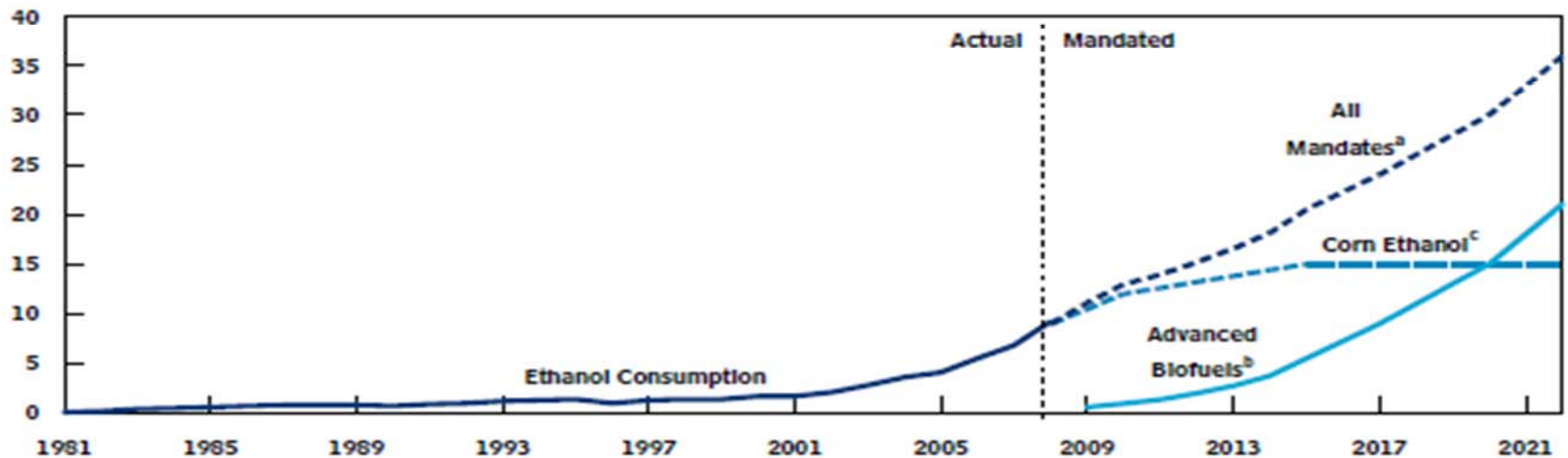
Ethanol Mandates 1981 - 2021



Figure 1.

Effect of Mandates in the Energy Independence and Security Act of 2007 on the Consumption of Biofuels

(Billions of gallons)



Source: Congressional Budget Office based on data from the Energy Information Administration.

- The mandates enacted in the Energy Independence and Security Act of 2007, or EISA (Public Law 110-140), require that by 2022, a total of 36 billion gallons of renewable biofuels (fuels made from biological raw materials) be consumed annually. The law also requires that corn ethanol make up no more than 15 billion gallons of that total.
- Advanced biofuels are renewable fuels not made from cornstarch that reduce greenhouse-gas emissions over the "life cycle" of the fuel (its production, distribution, and use) by at least 50 percent relative to emissions from gasoline.
- The Energy Information Administration estimates that annual corn ethanol usage will be 15 billion gallons between 2015 and 2022.



What Has Happened Now?



- Stocks are being rebuilt in wheat, corn and soybeans, however in corn and soybeans they are still tight
- Oil is increasing in price leading to attractive margins for ethanol plants
- \$US, after a brief respite, is continuing its depreciation relative to global currencies
- Index fund pressures are similar, but more scrutiny from regulators. They still have a presence in markets but prices have halved.

US\$ Index Limbo – How low can it go?



China – Prospective Grain Stocks



	Corn	Paddy	Soybeans	Wheat	Rapeseed	Total
1998/1999	68.8	60.4	1.3	97.7	0.3	228.5
1999/2000	77.4	62.0	1.3	106.8	0.3	247.8
2000/2001	67.4	64.4	1.3	97.8	0.3	231.2
2001/2002	60.8	58.0	1.3	84.2	0.3	204.6
2002/2003	48.1	38.3	1.3	81.2	0.3	169.2
2003/2004	39.4	18.9	1.3	62.7	0.3	122.6
2004/2005	29.3	18.8	1.3	63.6	0.3	113.3
2005/2006	22.9	20.7	1.0	63.3	0.3	108.2
2006/2007	28.9	21.6	1.0	67.9	0.3	119.7
2007/2008	30.7	23.9	1.0	61.3	0.3	117.2
2008/2009	39.6	33.9	5.5	69.7	3.0	151.7
2009/2010f	47.5	43.3	11.0	83.1	9.0	193.9
2010/2011f	49.9	53.0	16.0	98.3	15.0	232.2

Chinese Grain Growing

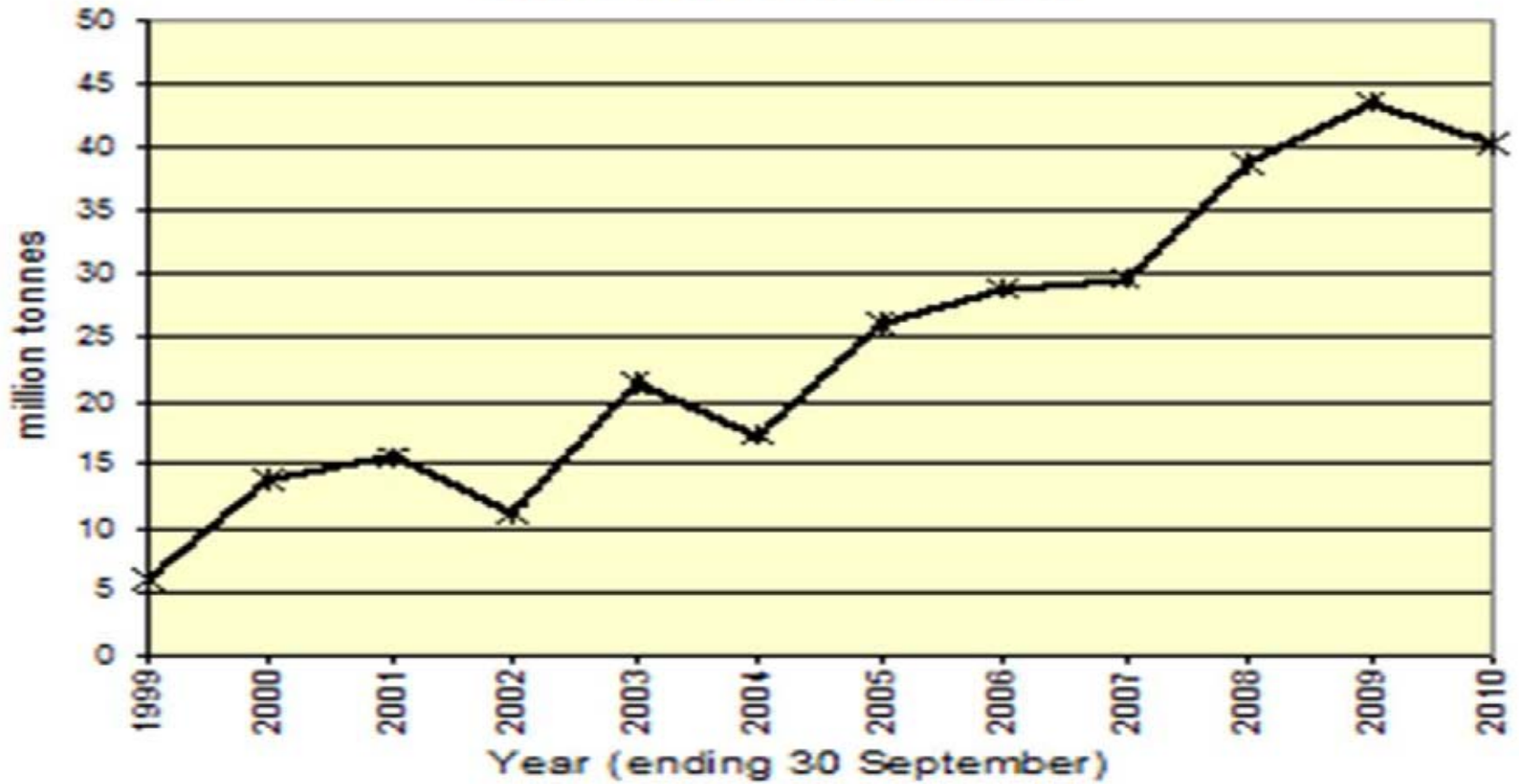


Harvest & Drying

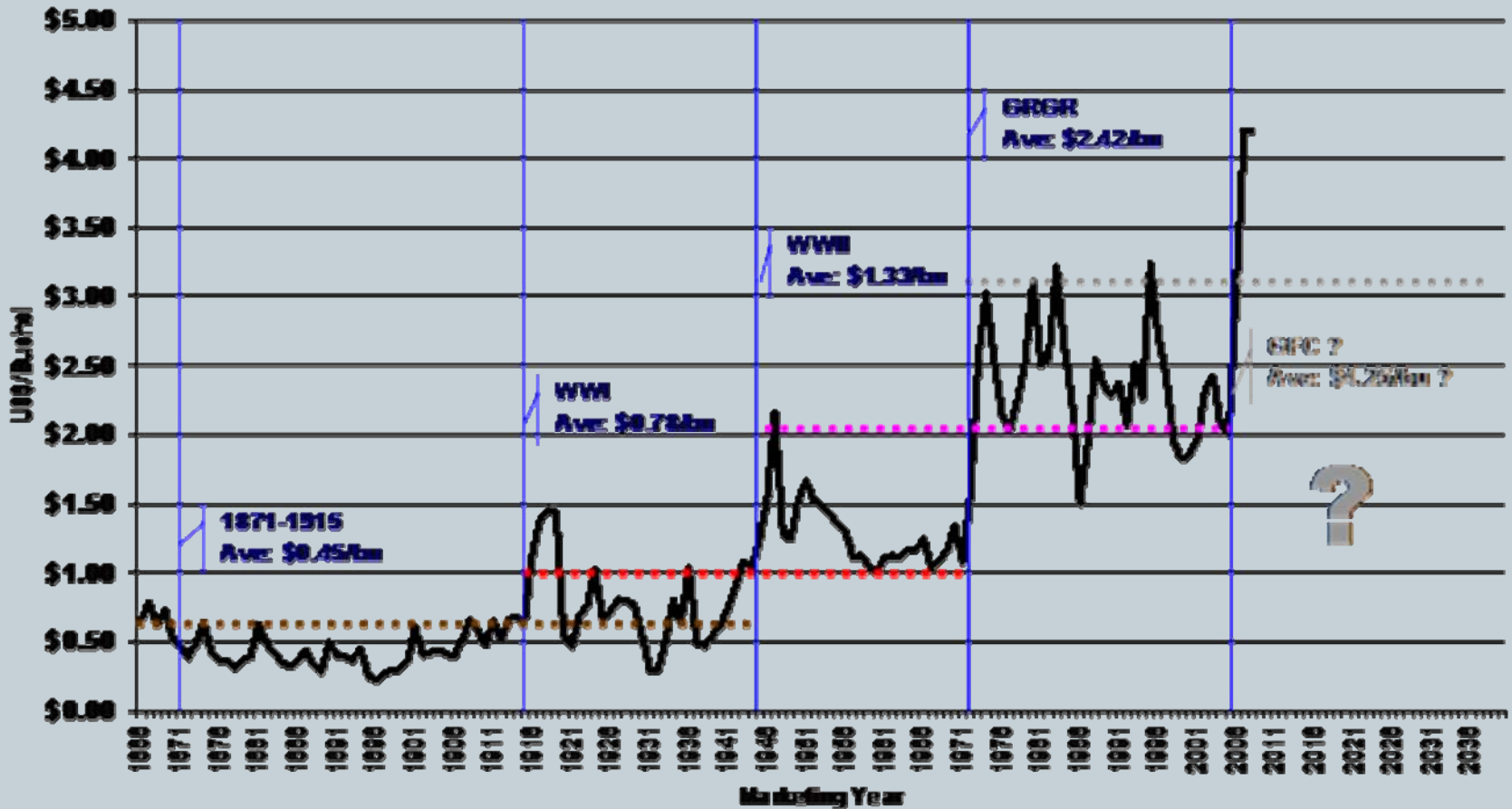
China



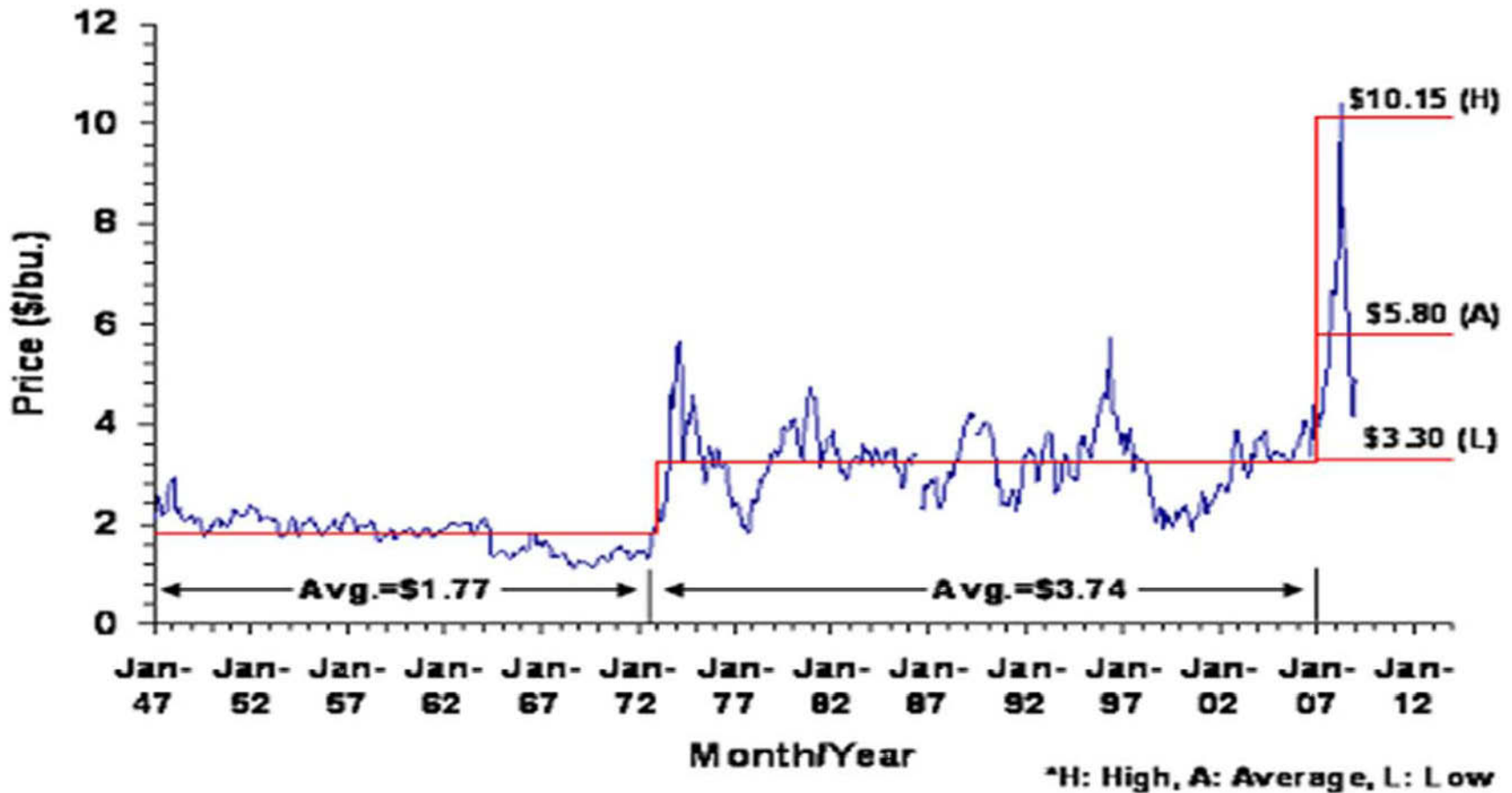
CHINA TOTAL OLSEEDS IMPORTS



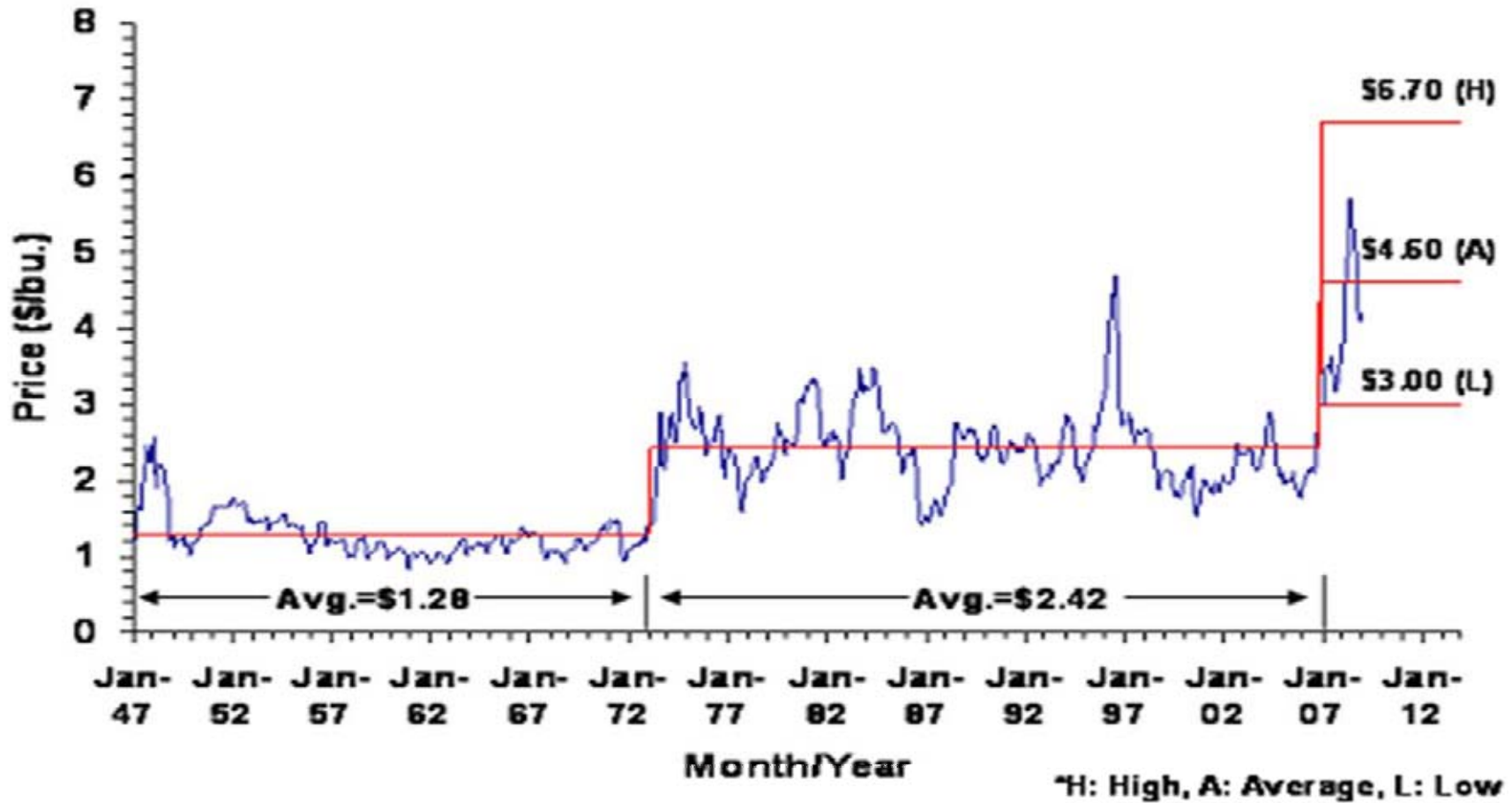
Price Predictions— Where Will We Go?



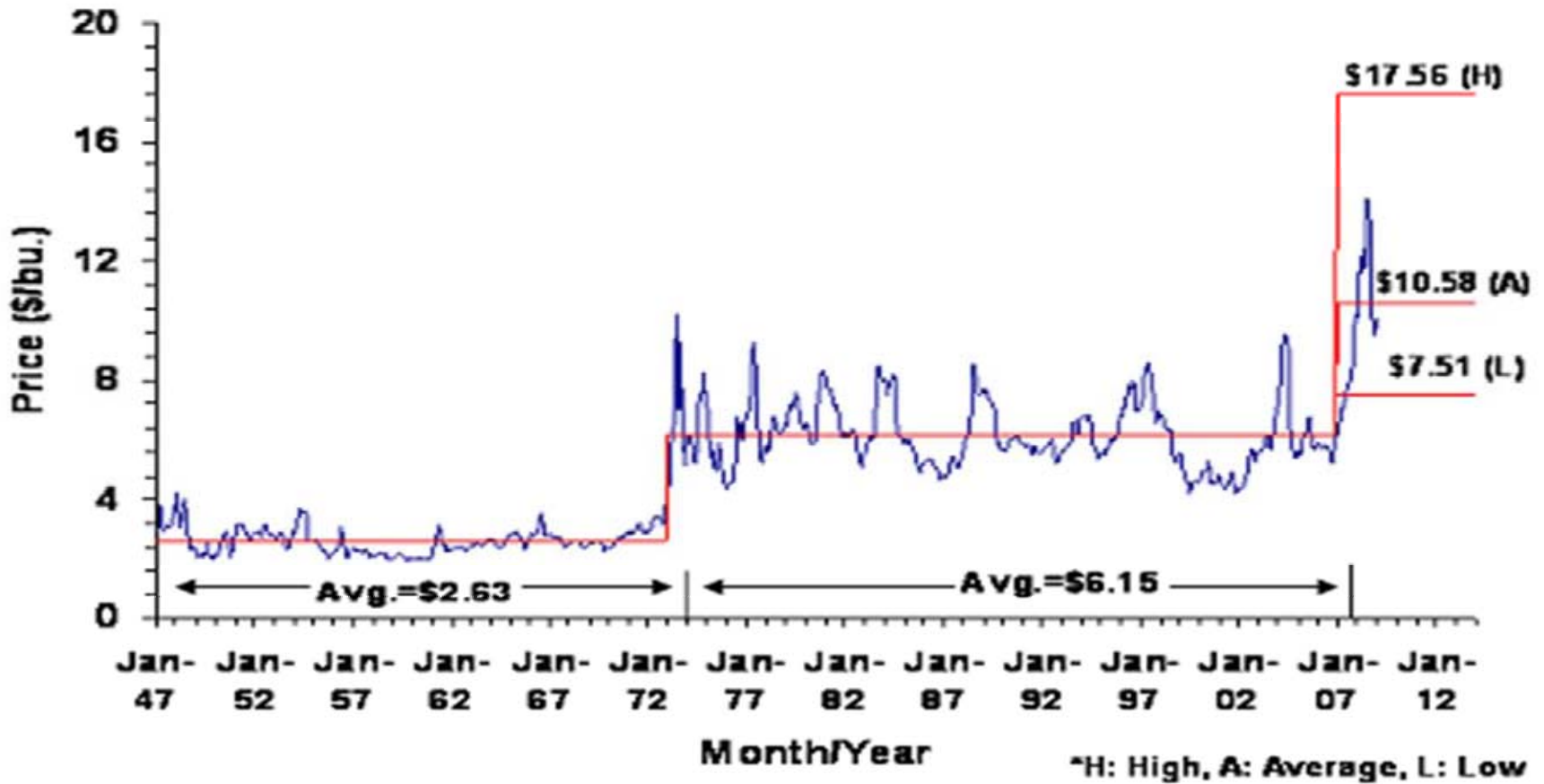
Wheat



Corn



Soybeans



*H: High, A: Average, L: Low



The Future – It Ain't What it Used to Be!



- The price of wheat will be driven more by corn and soybeans than its own fundamentals in the ST
- Supply shocks e.g. drought in USA?
- Impact of appreciating \$A on our returns?
- Volatility is here to stay?
- How will you manage this volatility, particularly given balance sheet risk with forward selling and production risk in Australia?

Our Marketing Tools

- Pools
- Cash at Harvest
- On – Farm Storage
- Cost Plus Selling
- Futures
- Options



Chicago Board of Trade

Pools



- Can they outperform the market average?
- Transparency
- Cost
- Risk with pool operator, e.g. Demurrage, rejection of cargos etc



Wheat Pit - Kansas
City Board of Trade

Cash at Harvest



- Transparent
- Satisfy cash flow needs?
- Increase in supply of grain as harvest progresses, weak sellers?
- Market can buy its fill and then drop price

Advance Trading –
Bloomington, Illinois



On – Farm Storage



- Why, system has plenty of capacity?
- Cost of silos v system
- What is the most efficient supply chain for your grain
- Can you fill it year in year out?
- Infrastructure turnover of storage – summer and winter crop
- Has to pay – consider basis and carry in the market, what is it telling you?
- If going down this path, need to think like an elevator

Mid-West USA Experience

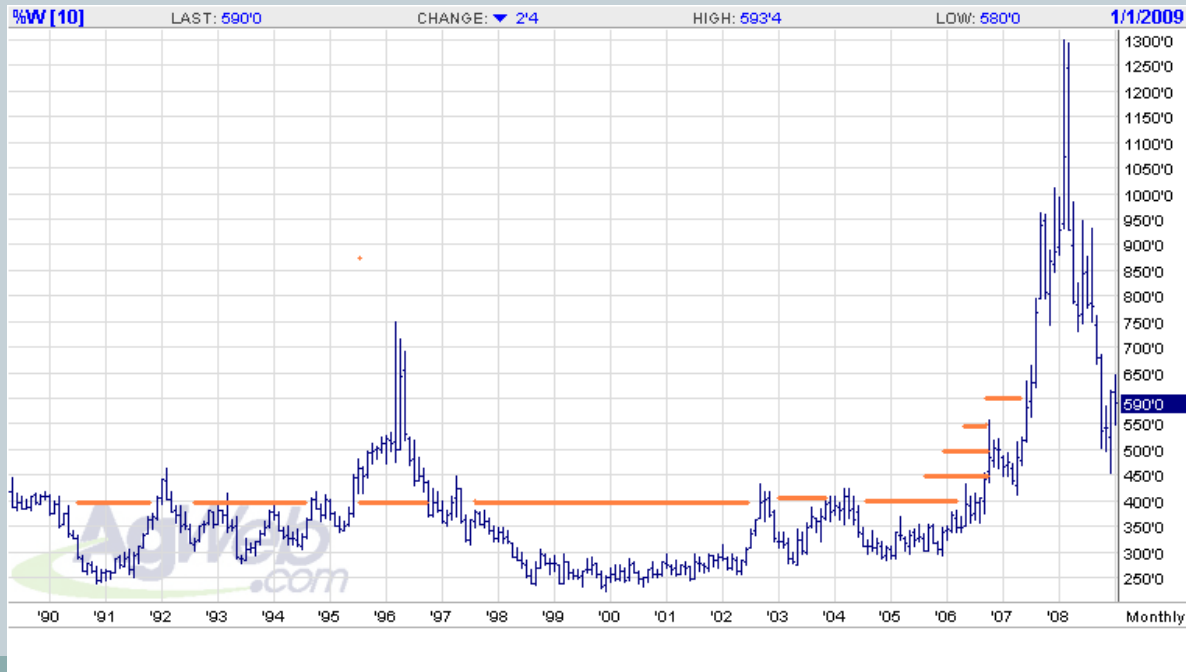


Ric Rosentreter,
Southern Illinois

Cost – Plus Selling



- Can be most profitable, but how much to sell and when? Can guarantee a profit?
- What is your cost of production given volatility in production



Futures



- Easy to get into
- Issues with production security in Australia – risk of overhedging – see 2006 and 2007!
- Zero sum game, Upside exposure in price is unlimited
- \$A futures moves in last 3 years are all around \$100/t. Can your balance sheet sustain those movements?

Options

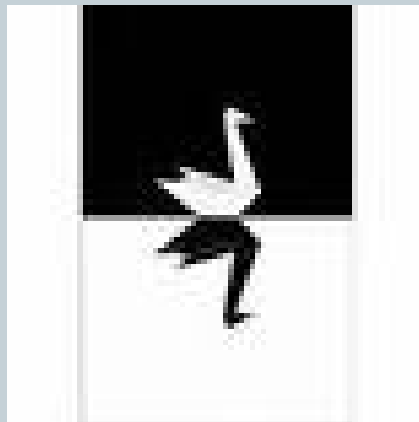


- Upfront cost
- Better able to handle volatility in prices
- Puts leave upside uncapped
- Insure for hail, fire, insure ourselves for medical and life insurance etc, why can't we insure for price?
- Alleviates production pressure and chances of overhedging when production declines.

Black Swans



- Outliers
- Extreme in their impact
- Concoct explanations *after* their occurrence, making it explainable and arguably predictable
- Why I think option strategies are preferable



Traditional Market Analysis



- Fundamentals – interesting but publicly available and built into the market
- Technicals – maybe short term trading but very unreliable for forecasting long term.
- Market advisors can't predict price movements either



Black Swans

Traditional Market Analysis



- No-one can predict market direction consistently and over time, unless you are an oracle!
- Why do farmers speculate on price movements?
- What information do farmers possess in Australia that will enable them to beat the market and full time professionals?
- Markets are driven by unknown information/expectations.

Ben Riensche



- Sells crop in 40 week increments over two years
- Focuses on being a low cost producer



Ben Riensche, Farmer
– Jesup, Iowa

Efficient Markets Hypothesis & Random Walk



- Everyday, all available information regarding a widely traded market is bid into the price
- Prices will reach equilibrium when the number of buyers equals the number of sellers
- Only unanticipated information will move prices lower or higher
- The chance of prices going up is just as likely as the chance of prices going down
- Consider the impact of expectations on the market i.e. good news isn't always good news

Why Not Accept Market Average?

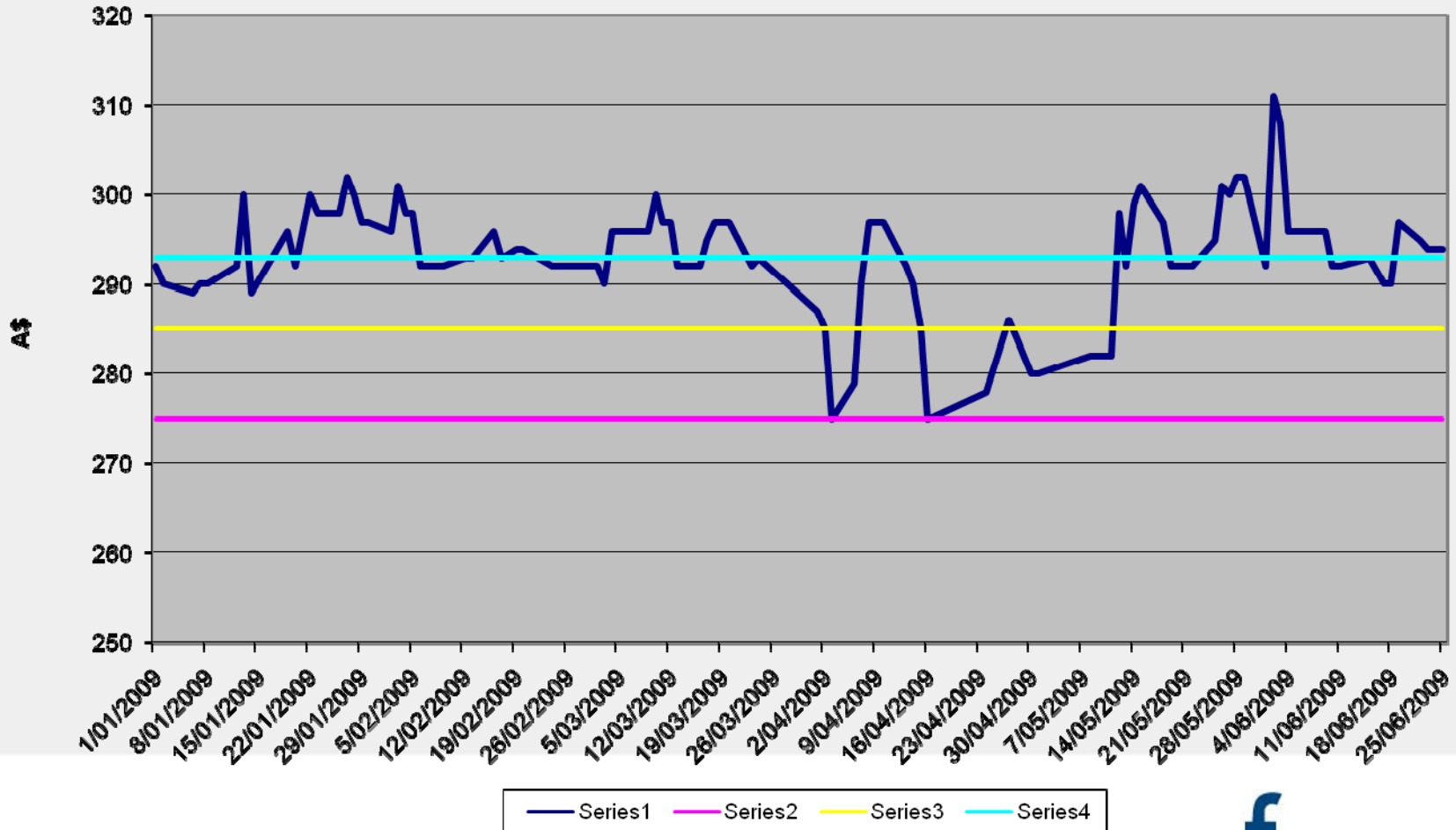


- Consider a passive style market approach i.e. Market average for a portion of our crop?



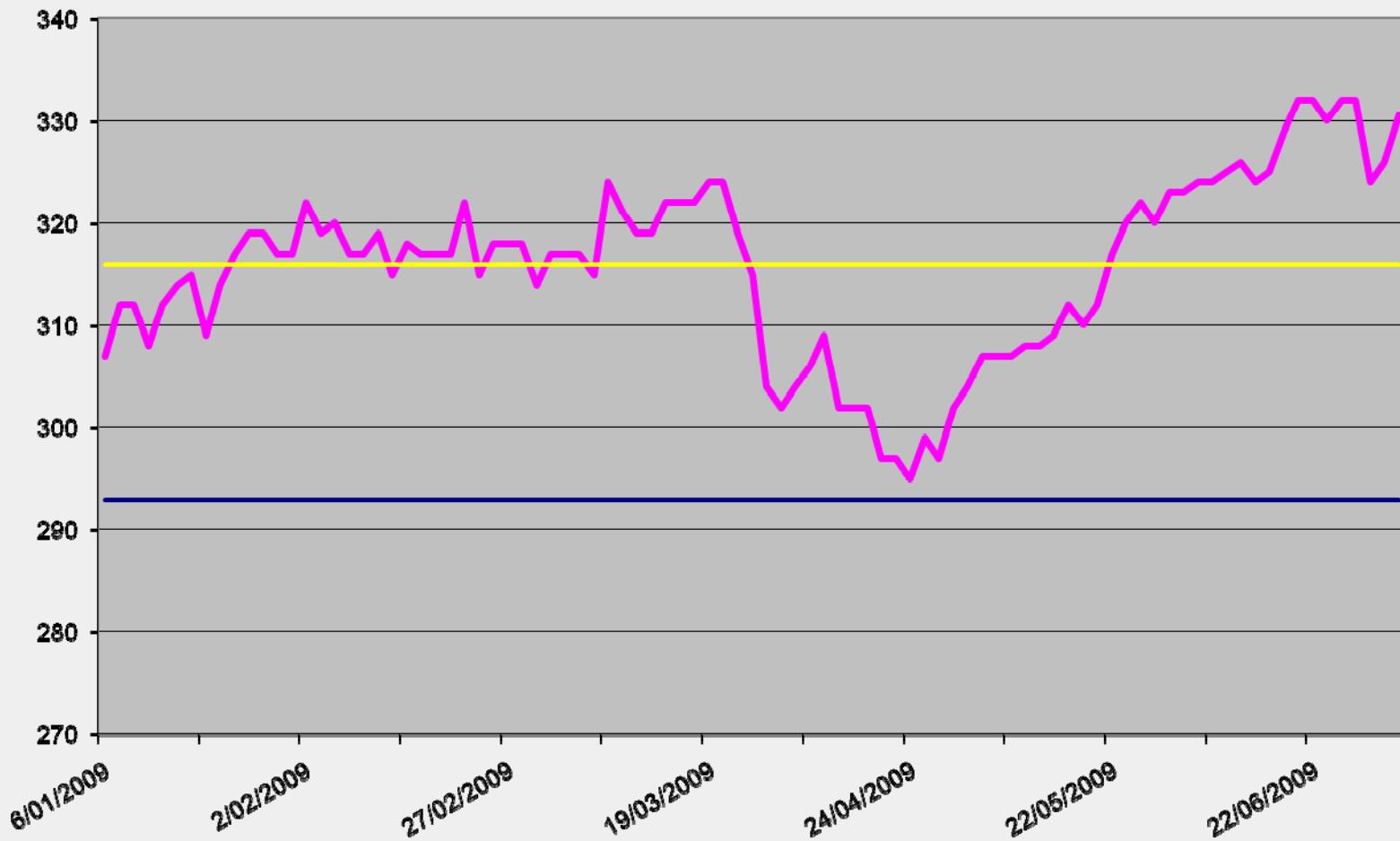
This year's 5 month Program performance

Port Kembla v Pool 1 v Pool 2
Track Comparison



This year's 5 month Program performance

Cash Bids v Pool
Track Comparison



— Track Bids APW2 — Current Pool — Advantage

Passive Style Marketing



- Agfarm introducing a passive pool this year, but cost at 2% track?
- Can undertake synthetically yourself?
- Hopefully more competition.
- Consider a portfolio approach with passive, active, cash at harvest and some stored grain?

Louis Dreyfus
Commodities –
Kansas City, Missouri



Why The Worry?



- Study by Nivens & Kastens (1999) found that price received had the least impact on farm profit, but cost of production and technology adoption had largest impact on farm profit.
- We should stop stressing about marketing and accept market average for a significant portion of our grain.
- **DARE TO BE AVERAGE!!**

Thankyou



- Questions?
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- Phone 0408 464776

Great Wall of China

