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## Nuffield Scholar dares Australian grain growers to be “average”

*“Dare to be different” and “dare to dream” are clichéd challenges, but Nuffield Scholar Bruce Watson is daring Australian grain growers “to be average” in a bid to successfully manage commodity price risks.*

**By Melissa Branagh-McConachy**

As global grain prices soared in 2007 and 2008, many growers questioned whether prices would remain “stronger for longer” or revert to previous levels. Determined to find the answers, New South Wales farmer Bruce Watson recently travelled through Asia, North America and Britain to develop a better understanding of the factors that drive global grains markets and identify lower risk hedging strategies.

After meeting stakeholders ranging from growers and grain merchants to futures traders and risk management advisors, Mr Watson is convinced that Australian growers should stop trying to “pick winners” – the tops of grain futures markets. They should instead focus on minimising costs and securing average market prices.

When Mr Watson applied for a Nuffield farming scholarship in June 2008, commodity prices had just come off all-time highs; the Chicago Board of Trade (CBOT) wheat futures topped at \$13.20/bushel. Australia had also endured back-to-back droughts, limiting production. The Watson family’s 3400-hectare property at Parkes, which is predominantly sown to milling-grade wheat, had recorded its lowest ever growing season rainfall.

Many growers had taken advantage of excellent forward selling opportunities to hedge their 2006 and 2007 crops, but were caught out when production fell and prices continued to climb, Mr Watson says. They found themselves writing substantial cheques to grain merchants or banks for losses on hedging accounts.

“While supply has comfortably exceeded demand over the past 12 months and softened grain prices, factors behind the 2007-2008 rise could combine again to send prices soaring,” he says.

Sponsored by Macquarie Agricultural Funds Management, the Nuffield Scholar spent part of his study tour identifying the issues underpinning grain price volatility. He concluded that factors driving the rise in wheat prices included higher demand from China and India; the increase in biofuel production; supply issues caused by adverse weather coupled with policies that interrupted global trade flows; rising crude oil prices; and the rapid depreciation of the US dollar.

Mr Watson also investigated a range of risk-management tools overseas and returned with two major recommendations. Firstly, Australian growers should re-examine the use of options instead of futures contracts, as he believes the former offer a less risky form of hedging, particularly for new crop production. Secondly, growers should also consider applying passive marketing tools, such as a market-averaging mechanism, to at least 50 per cent of their anticipated harvest.

“To speculate on future movements as part of a selling strategy is (now) foolhardy,” he says. “We need to be less focused on active strategies, such as trying to pick the tops of grain markets, and focus more on passive strategies and spreading sales over the marketing window, at least for the majority of the crop. This means being low-cost producers on the international market and accepting average prices for our commodities.”

This passive 'index fund' approach is favoured by Iowa corn grower Ben Riensche, an ex-Swiss banker who impressed Mr Watson during the US leg of his tour.

"Ben is an avid believer in the Efficient Market Hypothesis (an investment theory that states it is impossible to 'beat the market')," he says. "He breaks his crop down into increments of one-eightieth and markets every week over two years – half new crop, half old crop – excluding certain periods.

"Ben accepts an average price (because the price of commodities reverts to long-run average total cost) and focuses time otherwise spent poring over charts and reports on managing the (production) cost-base and becoming more efficient."

Like Ben Riensche, Mr Watson argues that even growers who think markets are corrupt do not have global-scale information that would enable them to pick market direction ahead of seasoned speculators and arbitrage departments at major investment banks.

He says the benefits of using a grain index could be outweighed by transaction costs for smaller growers, but believes the new Agfarm Advantage service, recently launched by national grain broker Agfarm, could provide opportunities to overcome some of these costs and achieve average prices.

"Agfarm Advantage markets grain in a pool over a five or 10-month period (20 per cent or 10 per cent per month) and is charging two per cent of the port track price, but competition should bring costs down," he says.

"After examining yield insurance products overseas, I also believe Australian governments should roll drought support into a partially subsidised commercial scheme to help growers manage business risk."

Mr Watson supports international evidence that cost-management and technology-adoption have a bigger impact on profit per hectare than price management. "The market doesn't respect growers' cost of production," he says. "We employ controlled traffic, zero-till and stubble retention practices on our property to boost productive capacity and efficiency, and in particular to reduce our cost of production."

The Nuffield Scholar intends to practice what he preaches, with plans to: sell 20 to 30 per cent of his crop at harvest to cover related costs; retain feed grain on-farm for storage; commit some of his crop to the GrainCorp pool; and allocate a percentage of his grain to the Agfarm Advantage product to generate regular cashflow.

"At the end of the day, the crop producers who survive will be those with the lowest production costs, since efforts to improve revenue through marketing will have limited success," he says.

## ENDS

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High-resolution photographs of Mr Watson can be downloaded from [www.coretext.com.au/communications\\_images.php](http://www.coretext.com.au/communications_images.php)

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## Captions:

Nuffield Scholar Bruce Watson says Australian grain growers should concentrate on "being low-cost producers and accepting average prices" to successfully manage commodity price risks.

Bruce Watson investigates global grains markets in the Wheat Pit at the Kansas City Board of Trade during the US leg of his Nuffield tour.