Why is Crop Marketing so Frustrating to Farmers?

• Crop prices are extremely volatile
  - Within year
  - Year-to-year

• Crop prices are hard to anticipate or forecast
  - Numerous price making forces that interact in a highly complex fashion
  - Acreage, yield, trade, livestock numbers, Asian RUST, policy,...
Compare Your Average Price Received to a Realistic Benchmark

Last Year? ______
3 Year Average? ______
5 Year Average? ______
A Systematic and Disciplined Approach

• **Step 1:** Start by getting the facts on marketing track record
• **Step 2:** Use a systematic and unbiased framework for benchmarking performance
• **Step 3:** Consider new marketing strategies in light of results in the first two steps
Complete Approach to Benchmarking

1. Assemble records for a given crop: bushels sold, cash and forward sales, futures and options transactions
2. Adjust each sale for moisture and quality discounts; sale prices should be stated on a No.2 basis for corn and No.1 basis for soybeans
3. Compute the weighted-average cash price received
4. Subtract physical storage charges on all bushels stored post-harvest
5. Subtract interest opportunity cost on all bushels stored post-harvest
6. Compute profit/loss on all futures and options transactions
7. Add LDP and/or marketing loan benefits??
8. Compare to the 24-month average cash price
   - Adjusted for storage costs
   - Include LDP/MLGs??
Quick Approach to Benchmarking

1. Assemble data to compute marketing weights each month over the 24-month pricing window for a crop year
   - Account for forward, futures and options sales

2. Multiply weights by monthly average prices
   - Prices should be adjusted for storage costs
   - Prices should be for a comparable area, e.g., central Illinois

3. Add speculative futures/options gains or losses

4. Include your weighted-average LDP/MLG gains??

5. Compare to the 24-month average cash price
   - Adjusted for storage costs
   - Include LDP/MLGs??
Evaluating Performance

• **Bottom Line:** Compare price received for a crop to the price offered by the market

• **Two important comparisons**
  – Top third of price range
  – Average price
Conventional Approach to Comparison of Crop Year Price Ranges

- Post-harvest cash prices only
- Range of prices = high - low
- Divide range into top third, middle third, and bottom third
- No adjustment for carrying costs
Better Approach to Comparison of Crop Year Price Ranges

• Pre- and post-harvest cash prices included (two-year marketing window)
• Adjustments for carrying costs (interest + commercial storage)
• Thirds based on equal number of days in each price range (time-weighted)
24-Month Marketing Window for Corn and Soybeans

Pre-Harvest Forward Bid

12 Months

September 1 (year t - 1)

First Day of Harvest (year t)

Post-Harvest Cash Price (Less Carrying Charge)

12 Months

August 31 (year t + 1)

24 Month Window
Conventional and Better Measurements of Price Range for Soybeans, 2003 Crop Year, Central Illinois

Note: LDP/MLG benefits not included.
Price Range for Corn, 1995-2003 Crop Years, Central Illinois

Note: LDP/MLG benefits not included.
Price Range for Corn, 1995-2003 Crop Years, Central Illinois

Note: LDP/MLG benefits not included.
Price Range for Corn, 1995-2003 Crop Years, Central Illinois

# Yrs. Farm > Mkt. Price: 2/9

Note: LDP/MLG benefits not included.
Price Range for Soybeans, 1995-2003
Crop Years, Central Illinois

Note: LDP/MLG benefits not included.
Price Range for Soybeans, 1995-2003
Crop Years, Central Illinois

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### Price Range for Soybeans, 1995-2003

**Crop Years, Central Illinois**

Note: LDP/MLG benefits not included.

<table>
<thead>
<tr>
<th>Crop Year</th>
<th>NASS Average Farm Price Received</th>
<th>24 Month Average Cash Price</th>
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<tr>
<td>1995</td>
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<td>2003</td>
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</tbody>
</table>

- # Yrs. Farm > Mkt. Price: 4/9
- Avg. Dif. Farm - Mkt. Price: +10
WHAT CAN DTN AgDaily DO FOR YOU?

Today, there are two ways for producers to increase their bottom-line profit: increase production efficiency or market more effectively. American farmers and ranchers are already producing at record levels... but USDA statistics indicate farmers sell two-thirds of their crop in the bottom one-third of the crop's annual price range.
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A Farmer’s Perspective

“If there’s anything I’ve learned in the past 30 years of studying and marketing grain, it’s this: Even with the right marketing plan and advisories, the critical calls to price grain are often not made.”

---Top Producer, December 2001
Potential Psychological Mistakes in Marketing

- Anchoring
- Loss aversion and regret
- Fallacy of small numbers
- Overconfidence
- Hindsight bias
Avoiding Psychological Mistakes in Marketing

• Focus on whole farm profits, not individual pricing decisions
• Focus on results over a large number of years
• Consider automated pricing strategies that cannot be reversed
New Generation Grain Marketing Contracts

• Contracts follow defined rules for generating sales
• Goal is to achieve a price near or above the average price offered by the market over a given time
Three Basic Types of New Generation Contracts

1. Automated pricing rules
2. Managed hedging
3. Combination of the first two
Averaging Contract

- Most basic form of automated pricing rule contracts
- Average price over some pre-specified time window
  - Average futures price, you set basis, or
  - Average a local cash price
- With some exceptions, focus on pre-harvest pricing windows
Motivation for Averaging Contracts

- Provide discipline to make systematic sales
- Finding that professionals and farmers have a tough time beating the market
- Consistent with idea of efficient markets (stock index funds)
More Complex Forms of Automated Pricing Rule Contracts

- Loan-rate provision
- Only sell on down days
- Establish minimum, maximum price or both
- Vary proportion sold by month
- Sell only when pre-specified targets are reached
Managed Hedging Contracts

- Bushels committed to contract are hedged according to the recommendations of a market advisory service
- Advisor may use a variety of instruments, including futures, options or forward contracts
- May include a minimum futures price
Combination Contracts

• An automated pricing contract plus share of professional’s hedging profits
  – Average price contract most typical
• May include a minimum futures price
• In addition to a service charge, may include additional incentive for professional
  – Example: if hedge in top third of price range, professional earns additional fee