Hedging Strategies for Ag Markets

Arkansas Bankers Association
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Why Being Proactive With Hedging is So Important Now and Going Forward

1) Historic weather Volatility-Grande Solar Cycle Minimum Etc.

2) Historic Price Volatility-Pandemic, record monetary and government interventions, deglobalization…

3) Historic Geopolitical Volatility-Russia/Ukraine, China/Taiwan Etc. potential escalation of war.

4) Dramatic shift in environmental policies altering supply and demand.

5) Currency destabilization I.E. digital money. Cryptocurrencies etc.

Key Hedging Principles

1) Keep it simple and avoid complex strategies.

2) Avoid strategies that could cause the farmer to incur incessant margin calls.

3) Deploy options strategies that have enough time to provide the producer a benefit

4) Be proactive with options as they all have an expiration date. Meaning if a hedge has given sizeable gains well before expiration one must look to accrue such gains as part of their overall hedging strategy.

5) Producers must make sure they have the capital to see hedging strategies through to their conclusion.

CBOE Volatility Index on the Rise

Ag Price Volatility on the Rise with Corn as an Example

Store Cash Grain and Protect Downside Price Risks-Ideally When Prices are Low I.E. 2020

1) This strategy involves buying put options on stored grain to protect downside price risks to lock in a floor while the producer waits for upside price volatility to offer a more attractive price to Cash Sell. If prices fall the producer has minimized his loss of farm income with the put option increasing in value. This allows the producer to avoid the worst-case scenario in case higher prices do not come.

2) Example Hypothetical: buying a corn March 23 6.50 put option for $.33 gives a $6.17 Floor to the producer. If corn prices drop to $5.00 the farmer would still get $6.17 adding $1.17 to his farm income versus someone who did not.

Cash Sell Stored Grain or future Supplies and Defend-Ideally Implemented When Prices are High I.E. 2022

1) **This strategy would entail making a cash sale of stored grain and then immediately buying call options to cover those cash sales and keeping the topside open. This strategy helps farmers have to courage to sell good prices and offers additional increases in farm income should prices move higher.**

2) **Example hypothetical: Make a cash sale on corn $6.75 and buy a corn March 23 7.00 call option for $.33 giving the producer a ceiling of $7.33. Should prices move to $8.00 the producer would ass $.67 to his farm income bushels versus someone who did not.**

Defend Future Production-Ideally Implemented When Prices are High or When Adverse Weather Makes Crop Projections Uncertain

1) **This strategy entails buying put options on future production in order to establish a floor and a minimum price. This strategy is typically done for producers who are not comfortable with aggressive forward cash selling or who have severe weather issues on their farms leading to great production uncertainty.**

2) **Example hypothetical: Buying December 23 6.00 corn puts for $.57 to establish a floor of $5.43. if Corn prices were to drop to $4.50 the producer would still get $5.43 providing a $.97 gain in farm bushel income versus someone who did not.**

Bull Call Option Spreads and Bear Put Option Spreads Can be Useful When Option Volatility premiums are very high

1) **This strategy entails buying a call option and then selling a higher strike price call option in the same month of expiration to help reduce the coast of the hedge. This strategy helps the producer establish a lower ceiling or higher floor but also caps potential benefit to the sold call strike price level. This is a non margin risk position. Bear Put Spreads are exactly the same but opposite with put options.**

2) **Example hypothetical: Buying December 23 6.20 corn calls for $.60 and selling December 23 7.20 corn call for $.31 establishing a net cost of $.29 or a ceiling of $6.49. Maximum gain on the hedge of $.71 ($1.00-$.29) occurs if corn prices are at or above $7.20 by expiration.**

Published By:

Hackett Financial Advisors, Inc.
Shawn Hackett, President
22641 Caravelle Circle
Boca Raton, FL 33433
561-573-3766
Email: Shawn@HackettAdvisors.com
www.HackettAdvisors.com