

FYI FROM FCI

Thanks, Gardner...



Market Volatility – Opportunity or Risk?

Torrey, Schildkamp, Hall, Weber

A year ago grain prices started a climb to record heights. It was a crash course in up-side risk. Will this year treat us to the same ride? Each year is different and this one more than most. Will we objectively assess the current markets or will our decisions be reactions to what we witnessed last year? Last year's markets had one theme: UP. This year's: VOLATILITY.

Consider current circumstances. Grain prices are at record highs when compared to the same date in history. Supply and demand, ethanol, speculators, the value of the dollar, etc. have all contributed. Transport costs have increased dramatically, both truck and rail. Price swings are larger and less predictable.

What does this mean for farms? There is significant opportunity to maximize profitability through purchasing decisions due to extreme market volatility. The upside of volatility is the potential for significant savings. The down-side is the risk of missed opportunity and higher purchase costs.

Two reasons for the high volatility/risk in grain markets are: uncertainty about the direction of the markets and the magnitude of price swings. For the first time, significant downside risk exists in the markets. The fact that grain markets are at a year on year high is reason enough to predict a potential downturn. What we have learned about speculators is another reason. Speculators are "relative" bargain hunters. When oil, real estate and stock prices were at all time highs, grain commodities were a relative bargain. Now that grain is at an all-

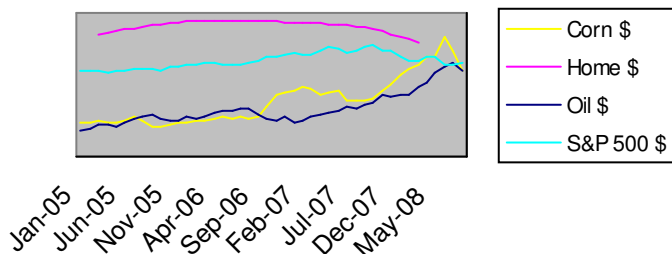
time high, will money flow back to real estate? Oil? Stocks? Or something else? This year's corn and soy harvest looks good, the global economy may be slowing and ethanol seems to be traversing a bumpy road. If you were a speculator, would you be putting your eggs into the grain baskets? – or somewhere else?

In most years, including last year, prices tend to rise after autumn. That may not happen this year. Booking too early could mean spot prices will be significantly below contract prices. Of course, that risk has always existed, but the magnitude... Think about the last time you booked early and missed the "bottom." Were you exasperated by the \$2, \$3 or \$5 a ton you could have saved? Regardless, by April, wasn't your "not quite the bottom" contract price significantly better than the spot? Well, those were the days of a more predictable market and \$2.00 a bushel corn. You probably missed the bottom by 5% or less. At \$2.00 per bushel, a ton of corn meal probably ran \$100. So, you booked for \$105 instead of \$100. By April the spot price was 10% higher than the low - \$110, so you still did ok. That same scenario with \$6.00 a bushel corn gives an \$11 spread in an up-market and a \$35 spread in a down market—\$35!

Booking Commodities In the past, booking has been a great tool for farms and feed companies to hedge against a predictable up-side risk but, booking in a down-market is a sure way to decrease profitability.

When a farm decides to book, a feed company is able to lock in a contract that guarantees a certain price for a certain quantity. In this way the farm and feed company are protected against any price increases. Since historically, prices were typically lowest in the fall and people booked in the fall, it worked well for handling up-side risk. But, only grains that could be future contracted could be protected (ie. soy, canola, corn). In the past, because these ingredients often made up the bulk of a grain mix and because other feed ingredient prices changed little, companies could offer a contract price for a complete grain mix. However, prices of all ingredients, from protein supplements to minerals, have been

Market Trends





increasing so rapidly that this has become more difficult. Another factor is that transportation costs have increased significantly. The contracts feed companies make with their suppliers have always stated that the seller can pass future increases in transportation costs on to the buyer. The current transportation surcharge that FCI is paying on some grains is 5 - \$10 per ton! Another wrinkle is that offers from commodities sellers to feed companies usually take place over the phone and it is implicit that the price offered is valid for the duration of the phone call only. This wasn't a concern with minimal daily and day-to-day volatility. These days, a price can go up or down \$20 in hours.

Risky Business Caution must be exercised this year due to higher risk/volatility – Avoid the urge to lock in the first price that sounds reasonable. The first price may not be best. Markets could continue to trend downward.

Feed Commodities' goal is to be a dependable partner for quality products and services at competitive prices for every customer. To accomplish this, FCI must be financially responsible. This means that any forward contracting must realistically assess market risk, reflect actual market prices, and clearly detail contractual obligations. In order to maintain competitive pricing for all customers, FCI must appropriately manage the risks involved with forward contracting. Inaccu-

racies in the execution of purchasing contracts could negatively impact competitiveness. Clear communication is crucial. Feed Commodities is committed to realistically assessing market risk and opportunities and to openly communicating market conditions and contract details with its customers. Making purchasing decisions too quickly without weighing all market factors could also place FCI and farmers at a competitive disadvantage. FCI is cautiously assessing current market conditions and objectively evaluating purchasing opportunities.

As you weigh your options going forward, keep in mind market volatility, the potential for a downturn and the possibility that a price quote from a feed company may not include freight costs and trucking surcharges. Remember that due to volatility, price quotes from feed companies may vary significantly from day to day. Comparing company A's quote on Monday to company B's quote on Wednesday may not be apples to apples.

Feed Commodities is ready and willing to help you manage market risk and opportunities. Before you make any final decisions on booking this year, please be sure to talk to FCI! Contact your local FCI representative to discuss your eligibility to book with us!

Don't forget - www.feedcommodities.com for current market info!

Higher Stakes in Commodity Markets					
Corn \$/bushel	Market Direction	Fall Market Low corn meal \$/ton	Contract Price 5% over low	spot price - 10% change from market low	Difference: spot - booking
\$2.00	Up	\$100	\$105	\$110	\$5
\$6.00	Up	\$230	\$242	\$253	\$11
\$6.00	Down	\$230	\$242	\$207	-\$35

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