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Dear Ag Industry Associate,

Every year presents its own unique challenges to producers managing forward margin opportunities. Some events affect widespread industries across the crop and livestock spectrum such as droughts, while others are narrower in scope such as the PEDv outbreak last year which had a significant impact on hog producers. Because each year is different with factors that can influence margin management decisions, we advocate taking a longer-term view and analyzing margin opportunities within a historical context. While this approach can help bring perspective to the decision making process, there are many different ways the margin can be historically analyzed. Our feature article this month, "Historical Analysis and Margin Management" discusses some of these approaches and highlights how hog producers may choose to look at forward margin opportunities within the context of history and the impact from PEDv in 2014.

One recent development that is impacting all industries is the announcement from the EPA of their biofuels targets for 2014, 2015 and 2016. The long-awaited mandates will be fiercely debated over the next several months until final figures are determined in November. Regardless of what targets are eventually agreed upon though, it appears evident that the exponential growth of corn demand as a feedstock to fuel ethanol production has come to an end as the blend wall constrains growth. While advanced biofuels remain a different story, this theme will have consequences for the forward margins of both crop and livestock producers, and our regular Margin Watch reports summarize this for each of these industries.

Sincerely,

Chip Whalen  
Managing Editor

*Managing Editor, Chip Whalen is the Vice President of Education and Research for CIH, a leader in Margin Management. He teaches margin seminars throughout the country and can be reached at [cwhalen@cihedging.com](mailto:cwhalen@cihedging.com)*

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# Historical Analysis and Margin Management

One of our first articles in Margin Manager last year discussed evaluating a forward margin opportunity and how to objectively measure that opportunity from a historical perspective. Because no one has a crystal ball to know what the future will bring, the best we can do when considering a projected margin opportunity is to put it into a historical context and ask how good or bad the opportunity is within this context. This begs the question of what exact history we are considering though. In the article last year, we mentioned evaluating the margin from a 10 year perspective, and ranking the opportunity within this historical range to determine how strong or weak the projected margin is when compared to that history. The reason why we typically default to a 10-year period is that margins cycle over time, and 10 years of history usually allows us to capture a complete cycle of both very strong and very weak margin years to establish percentile rankings.

Generally speaking, the longer the time horizon one uses, the more history they will have to capture all of the margins that occurred for a certain period, such as the fourth quarter for example when evaluating a current opportunity. Sometimes, it may be desirable to choose a different history though to see the margin opportunity from another perspective. As an example, livestock producers such as a hog, dairy or beef cattle operation that feed corn faced a quandary over the past five years when evaluating their corn cost. With the advent of ethanol in the second half of the last decade, corn prices reached levels never seen before which began to skew the percentile rankings. An average price of corn 5 years ago when considered within a 10-year context may have been around \$3.00/bushel or less. When considered within a shorter horizon however such as over a 5-year span, this same \$3.00/bushel price may have represented a low for that period. Many of the producers we work with commented how expecting corn prices to revert back significantly below \$3.00/bushel may have been unrealistic, and therefore wanted to use both a 5-year and a 10-year history when evaluating their margin opportunities.

More recently, other occurrences have skewed prices and affected margin percentiles as well. As an example, 2014 was a unique year for hog producers due to the impact of PEDv, not only on production, but also on margins. As can be seen in the chart below, which stacks the last 10 years of 4Q margins on top of one another, the lofty margins of 2014 will have a significant mathematical impact on 10-year margin percentiles:

*Please see chart on the following page.*

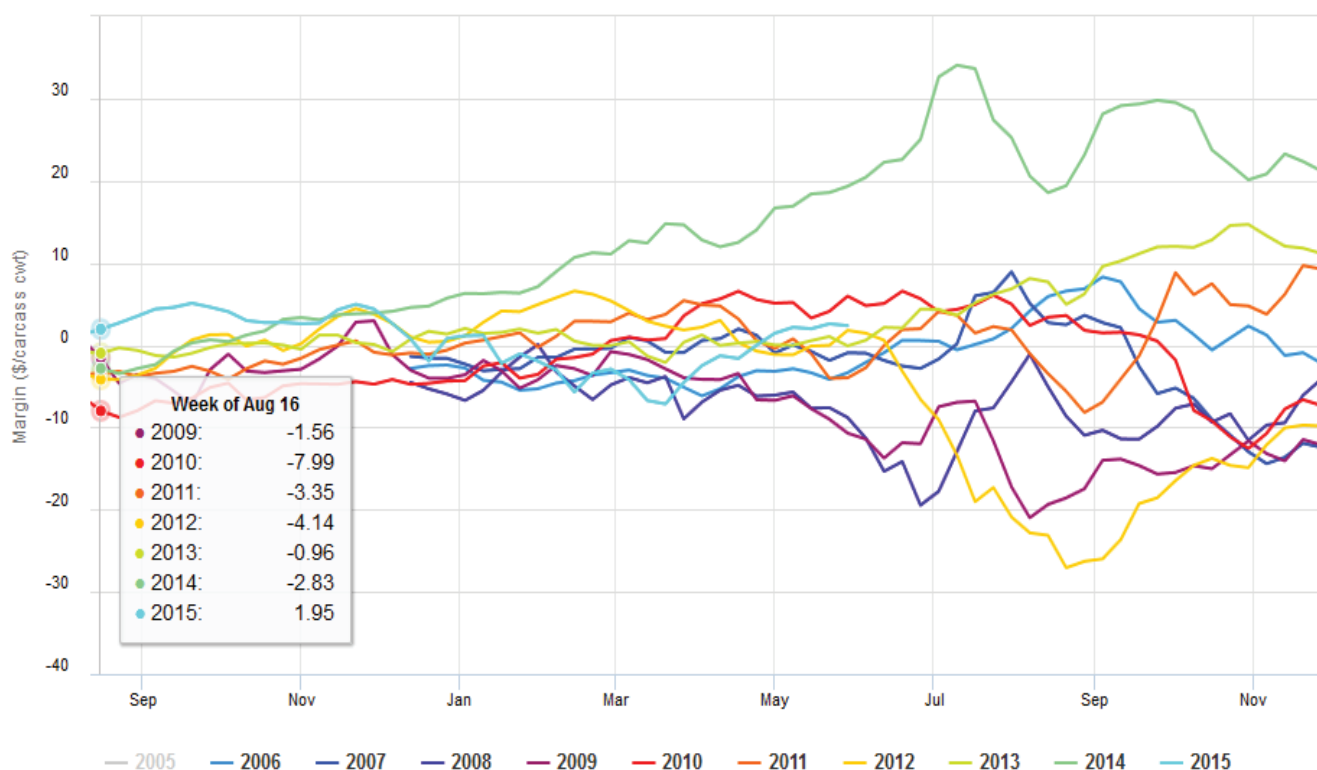
## Historical Analysis and Margin Management

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### Graphs - 4th Quarter 2015

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Worksheet: 4th Quarter 2015 Chart Type: Margin History Stacked Range: 10 Year



To see the impact of the effect from 2014 margins on historical percentiles, the 2 tables below show 4Q 2015 margin percentiles. The first table displays the 10-year percentiles including 2014. The second table is the same view for 4Q 2015 margin percentiles, but excluding the year 2014 from the calculations. You will notice that the prices for corn, meal, lean hogs and the calculation of the open market margin are the same between the two tables, however the percentiles are much different:

*Please see chart on the following page.*

## Historical Analysis and Margin Management

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	Corn Dec15	Meal Dec15	Lean Hogs Oct15, Dec15, Feb16	Open Market Margin
Current Price	\$3.67	\$297.30	\$70.92	\$2.67
Percentile	19.75%	40.72%	41.82%	71.07%
High	\$8.39	\$535.30	\$105.93	\$35.37
90th	\$6.45	\$385.20	\$88.00	\$8.88
80th	\$5.87	\$360.40	\$83.97	\$4.63
70th	\$5.43	\$348.20	\$80.70	\$2.48
60th	\$4.86	\$332.50	\$77.08	\$0.85
50th	\$4.43	\$314.30	\$74.17	\$-0.34
40th	\$4.14	\$296.50	\$70.06	\$-1.98
30th	\$3.89	\$278.30	\$67.20	\$-3.56
20th	\$3.67	\$252.60	\$63.77	\$-5.46
10th	\$2.72	\$196.50	\$58.16	\$-9.99
Low	\$1.86	\$158.90	\$45.21	\$-28.20

As you can see in the table above, the 90th percentile for 4Q15 margins is \$8.88. When making decisions on managing 4Q15 margins, if you are waiting for the 90th percentile to implement a particular margin management strategy, that may prove difficult to achieve, considering the 90th percentile prior to 2014 and excluding that year was \$5.52, as can be seen below:

*Please see chart on the following page.*

## Historical Analysis and Margin Management

Continued from previous page.

	Corn Dec15	Meal Dec15	Lean Hogs Oct15, Dec15, Feb16	Open Market Margin
Current Price	\$3.67	\$297.30	\$70.92	\$2.67
Percentile	20.36%	45.62%	46.84%	78.45%
High	\$8.39	\$535.30	\$92.18	\$16.48
90th	\$6.51	\$381.50	\$85.18	\$5.52
80th	\$5.99	\$358.40	\$82.38	\$3.04
70th	\$5.56	\$345.00	\$79.20	\$1.30
60th	\$5.13	\$323.00	\$75.78	\$0.09
50th	\$4.52	\$306.40	\$72.52	\$-1.16
40th	\$4.17	\$288.20	\$68.49	\$-2.72
30th	\$3.90	\$269.30	\$66.25	\$-4.11
20th	\$3.65	\$243.60	\$62.90	\$-6.16
10th	\$2.65	\$191.20	\$57.45	\$-10.92
Low	\$1.86	\$158.90	\$45.21	\$-28.20

In other words, how often have \$8.88 margins been available to hog producers over the last 10 years? Excluding 2014, not very often, and for fleeting moments at that as can be seen in the next chart which plots 10 years of 4Q margin history for this model hog operation with the \$8.88/cwt. margin level indicated by the purple horizontal line in the graph:

*Please see chart on the following page.*

## Historical Analysis and Margin Management

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### Graphs - 4th Quarter 2015

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Worksheet:  Chart Type:  Range:   
Percentile:  Percentile Range:



This gets to a fundamental point about what the purpose of historical analysis is in margin management. It is ultimately to help guide decisions on how to best manage forward opportunities and protect margins. The decision to even take action in the first place will often be predicated upon reaching a margin threshold, such as the 90th percentile of a certain historical range for example. Whether this threshold is even attainable is something that needs to be carefully

## Historical Analysis and Margin Management

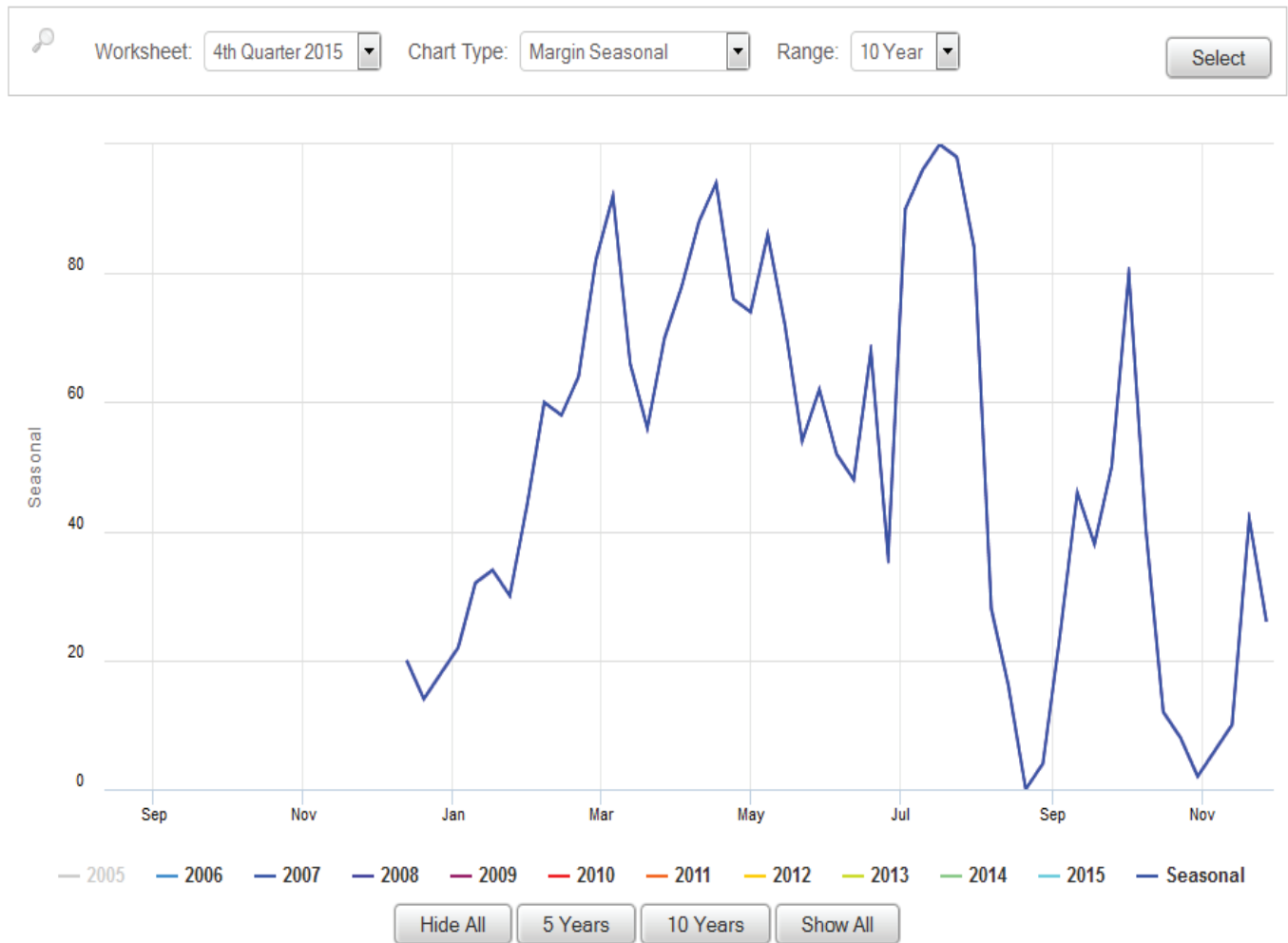
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evaluated when considering the history in question. If I will only add coverage in Q4 for my hog operation if we reach the 90th percentile, that may be difficult to achieve. Similar to how the impact of ethanol effected corn prices and skewed percentiles over the past 8 years, hog producers should be aware of the effect that the year 2014 is having on their percentiles and base margin decisions on this analysis accordingly.

In addition to the impact that 2014 is having on margin percentiles, there has also been a noticeable impact on margin seasonality, which is another tool that producers will typically incorporate into the timing of their margin management decisions. The graphs below depict the 10-year seasonal chart of the same 4Q margins as above. The first chart includes 2014 in the calculations and the second chart excludes 2014.

### Graphs - 4th Quarter 2015

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## Historical Analysis and Margin Management

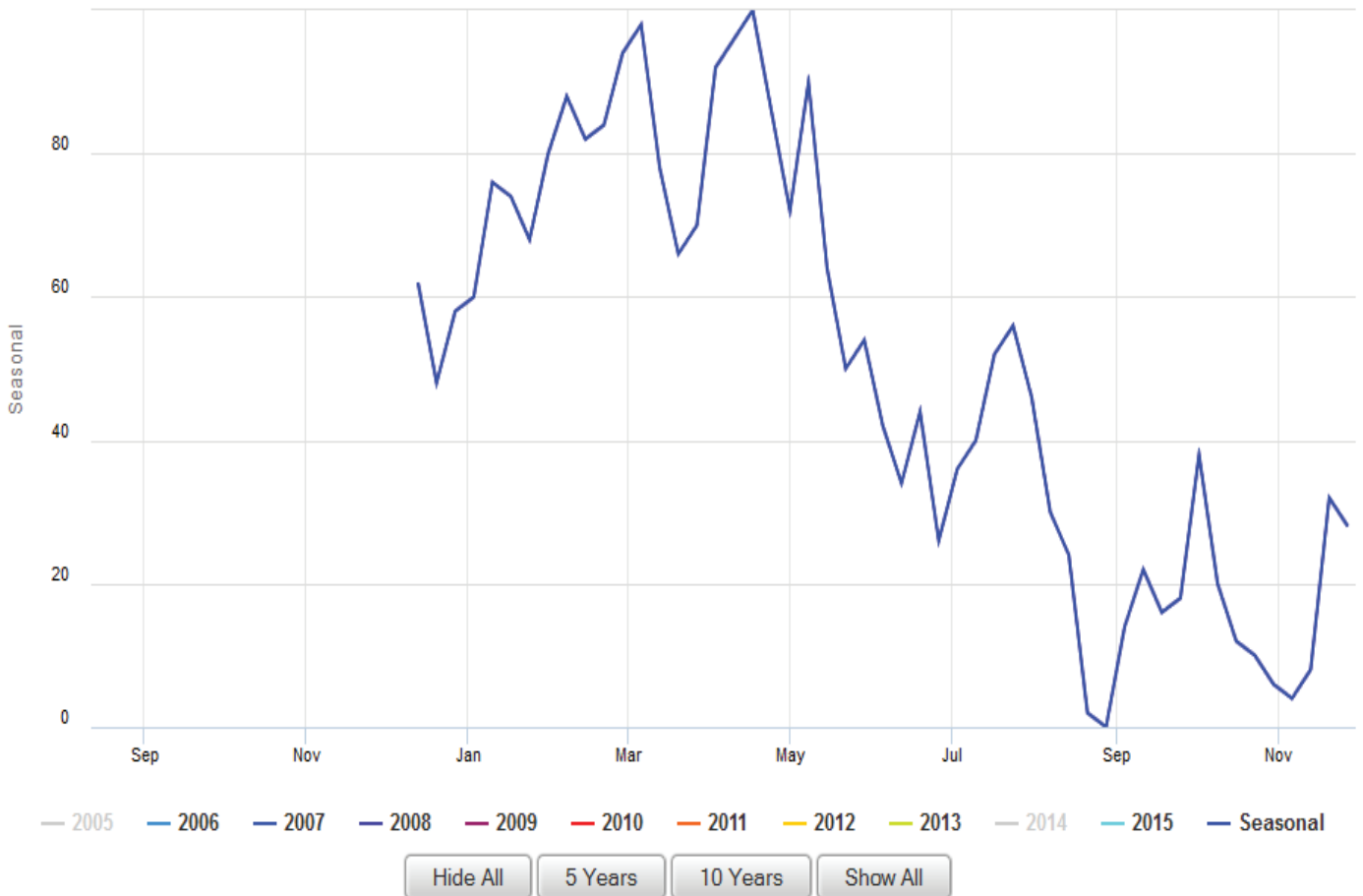
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By including 2014, a producer may be more willing to remain patient into July to add margin coverage. However; without 2014's effect on the seasonal chart, a producer might have been more proactive in establishing coverage earlier this spring when 4Q margins typically show a seasonal high in the April timeframe:

### Graphs - 4th Quarter 2015

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Worksheet:  Chart Type:  Range:



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### Historical Analysis and Margin Management

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While there certainly is no “right” way to evaluate margins within a historical context, it is important to realize that there is more than one way to look at the history in making margin management decisions. Fortunately, our tools allow a producer to explore this history a number of different ways. Analyzing historical ranges from both shorter and longer-term perspectives, as well as including or excluding certain years in the margin history are examples of how these views can be customized to enrich the evaluation of margin opportunities. While it would not be correct for example to say that a producer should only look at a shorter-term historical range in a certain situation or ignore a particular year in their analysis, it is important to note the impact recent price history can have on historical percentiles or how the effect of one particular year can impact historical margin percentiles and seasonality. A producer for instance may opt to consider both a 5 and 10-year (or longer) history in evaluating prices and margins. Similarly, they may choose to include or exclude certain years in their historical analysis. Just as how 2014 was a very positive margin year and could therefore skew margin percentiles, 2009 was conversely a very negative year to margins and might also be selected to include or exclude in making historical evaluations. Regardless of the approach taken though, the goal is to make more informed, time-sensitive, margin management decisions and ultimately capture favorable opportunities.

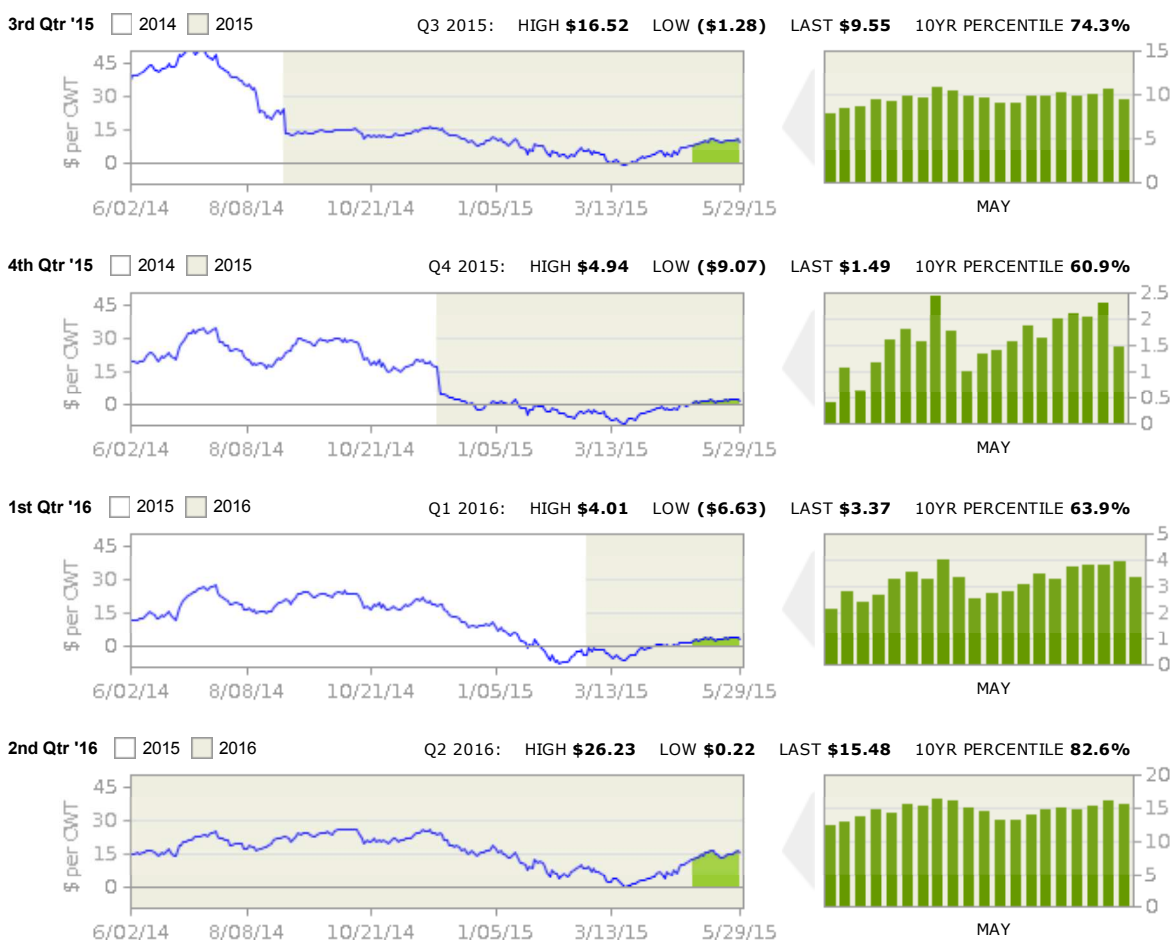
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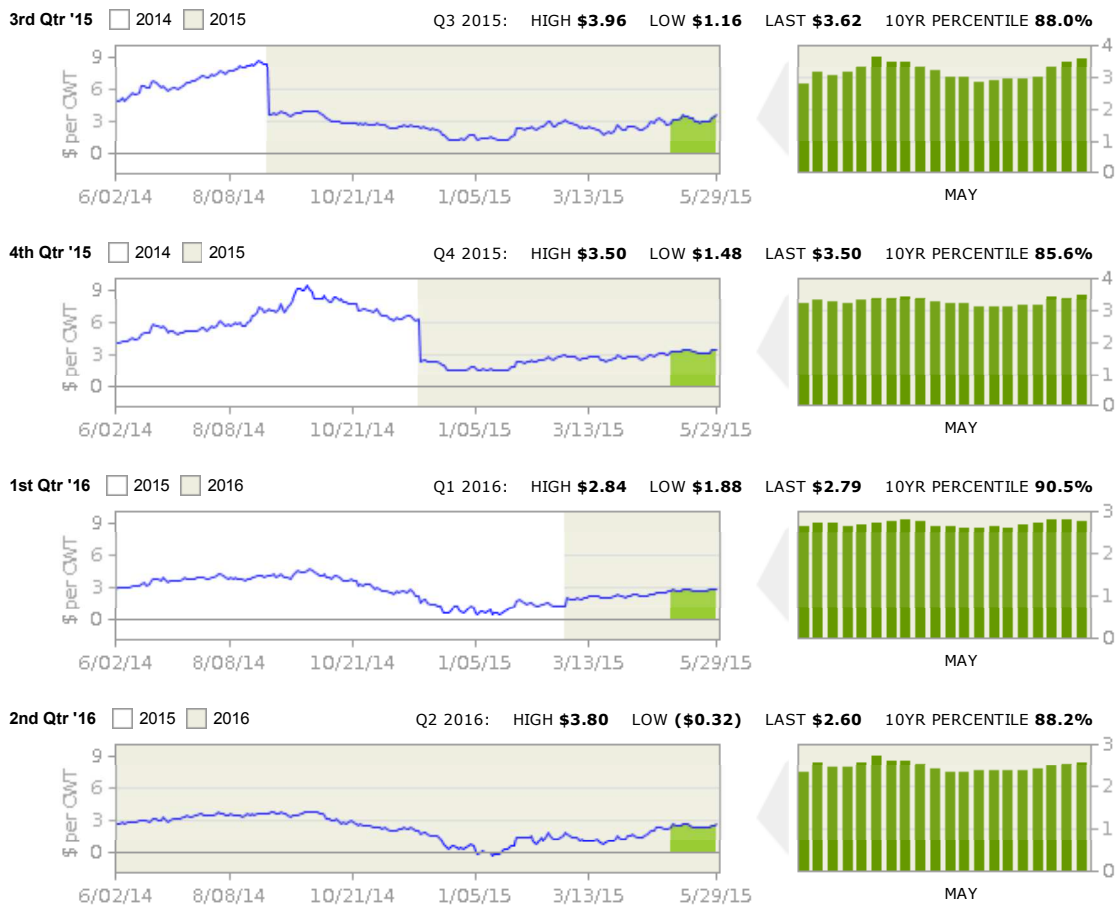
Margins continued to strengthen over the last half of May, supported primarily by declining feed costs as hog prices held relatively steady over the past two weeks. Spot Q2 margins remain over the 80th percentile of the previous 10 years while Q3 is just below that level with the deferred slots of Q4 and Q1 of 2016 just above the 60th percentile. Corn prices have continued their slow deterioration on beneficial planting progress and crop conditions while demand remains lackluster. USDA reported corn 92% planted as of May 24 versus 86% last year and the 10-year average of 88% as of this date. USDA also put the condition of the crop at 74% good-excellent compared to the 10-year average of 71% and just 4 points shy of the 78% high for this date back in 2007. The EPA meanwhile released their long-awaited renewable fuel targets for 2015 and 2016, pegging the 2015 biofuels target at 16.3 billion gallons compared to the original 2007 law at 20.5 billion and the 2016 biofuels target at 17.4 billion gallons versus the 2007 law at 22.25 billion. The corn ethanol targets in particular were much lower than what the industry was hoping to see, suggesting demand for corn has plateaued as the blend wall constrains growth. While hog futures have held close to recent highs, the upside momentum appears to be waning. USDA's monthly Cold Storage report pegged April 30 frozen pork stocks at 699.6 million pounds, up 19.8% from last year and 17.5% higher than the 5-year average. Our clients continue to focus on making strategic adjustments to existing positions, including strengthening hog hedges. Improving margins are also beginning to trigger alerts in deferred periods to establish new coverage.



The Hog Margin calculation assumes that 73 lbs of soybean meal and 4.87 bushels of corn are required to produce 100 lean hog lbs. Additional assumed costs include \$40 per cwt for other feed and non-feed expenses.

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Dairy margins strengthened over the second half of May, supported by a combination of higher milk prices and lower feed costs. Forward margins remain very favorable from a historical perspective, well above the 80th percentile of the previous 10 years through the remainder of 2015 and at the 90th percentile for the first quarter of 2016. Milk continues to be supported by higher trade in the spot butter and cheese markets at the CME, with cash butter closing up a sharp 10.25 cents Friday to \$2.005/lb. while cash block and barrel cheese trade was up 4 and 6 cents respectively for the week. USDA's Cold Storage report pegged April 30 butter stocks at 230.4 million pounds, up 46.1 million from March compared to a five-year average seasonal build of about 21 million pounds. Cheese stocks totaled 1.08 billion pounds, up 15.6 million or 1.5% from March 31 and very close to the average increase of 17.2 million pounds from March to April. Corn prices have been under pressure from fast planting progress and relatively high crop condition ratings. USDA placed corn planting at 92% complete as of May 24 compared to 86% last year and the 10-year average of 88% by this point. Corn was also rated at 74% in good-excellent condition compared to the 10-year average of 71% for this date. Meanwhile, the EPA finally released their renewable fuel targets for 2015 and 2016, which suggested that demand for corn from ethanol has plateaued as the blend wall constrains growth. The 2015 biofuels target was set at 16.3 billion gallons versus the original 2007 law at 20.5 billion while the 2016 target was placed at 17.4 billion versus the original target of 22.25 billion in the 2007 law. Our clients have been building new coverage in deferred periods given the strong forward margins, while also adjusting existing positions to add more flexibility for revenue hedges in particular.

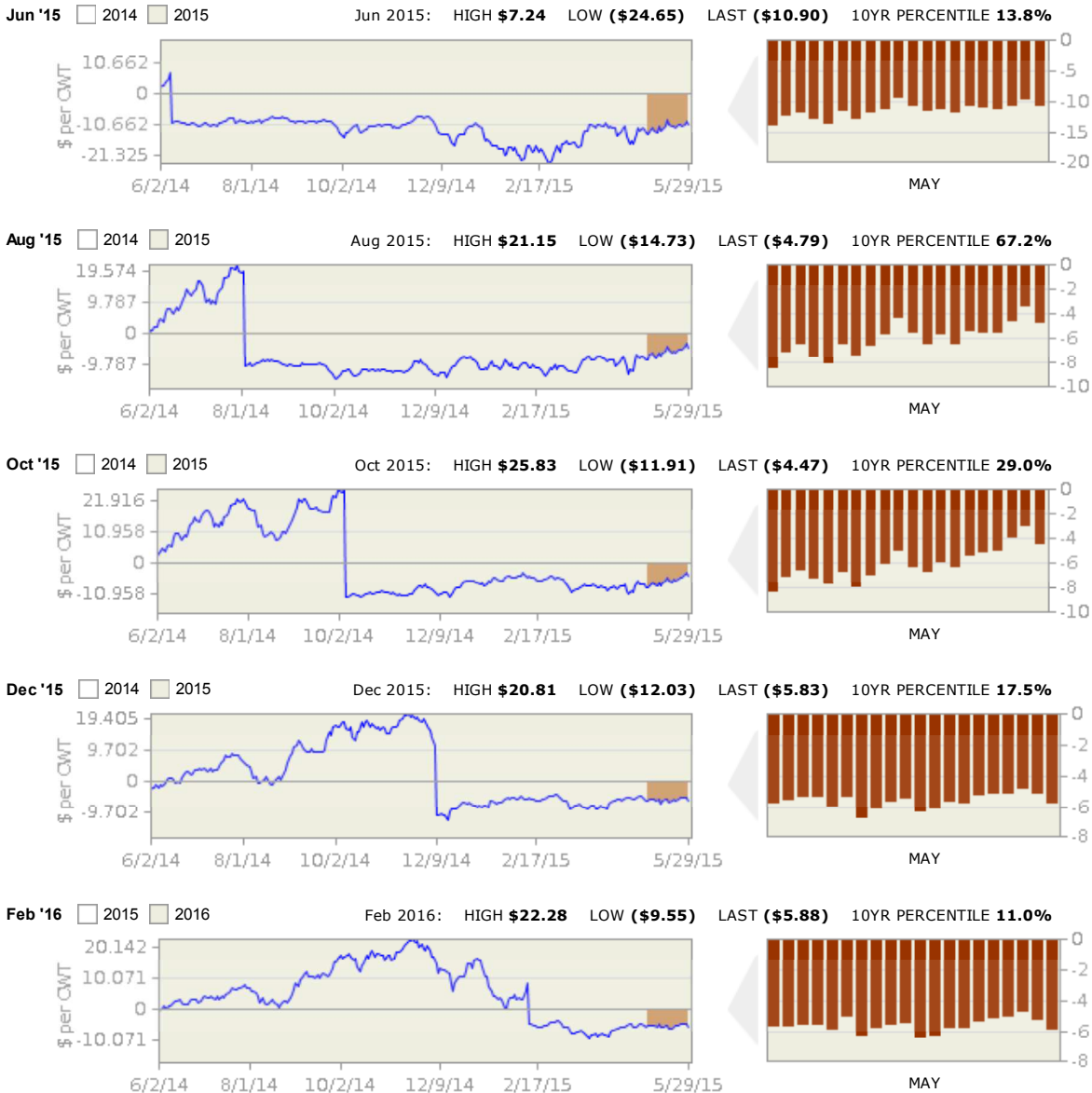


The Dairy Margin calculation assumes, using a feed price correlation model, that for a typical dairy 62.4 lbs of corn (or equivalent) and 7.34 lbs of meal (or equivalent) are required to produce 100 lbs of milk (includes dry cows, excludes heifers not yet fresh). Additional assumed costs include \$0.90/cwt for other, non-correlating feeds, \$2.65/cwt for corn and meal basis, and \$7.00/cwt for non-feed expenses. Milk basis is \$0.75/cwt and non-milk revenue is \$1.00/cwt.

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Beef finishing margins generally improved over the second half of May, due mainly to a decline in feed costs with cattle prices steady to slightly higher over the past two weeks. Margins still remain deeply negative and historically depressed, offering few opportunities for feedlot placements. In addition to strong incentives for heifer retention to rebuild the beef cattle herd, this may be a reason why placements were so low in the latest monthly Cattle on Feed report. USDA pegged April placements of cattle into feedlots of 1,000 head or more at 1.548 million head, down 4.6% from last year and outside of the range of pre-report estimates that expected no lower than a 2.6% decline from 2014. Corn has been under steady pressure from the quick planting pace and generally favorable crop conditions. USDA reported that 92% of the crop has been planted as of May 24 compared to 86% last year and the 10-year average of 88% for this point in the season. The crop was also rated in 74% good-excellent condition compared to 71% on average for this week and just 4 points off of the high set back in 2007. Meanwhile, the EPA finally released their long-awaited renewable fuel targets for 2015 and 2016 which suggested that corn demand from the ethanol sector has plateaued as the blend wall constrains growth. The 2015 biofuels target was placed at 16.3 billion gallons compared to the original 2007 law at 20.5 billion while the 2016 target was set at 17.4 billion gallons versus the original 2007 law at 22.25 billion. Our clients continue to monitor forward margin projections while evaluating adjustment opportunities on existing positions. Adding flexibility to feed hedges ahead of a more seasonally volatile period of summer weather is an area of focus our consultants have been reviewing with clients recently.

## Live Cattle Marketing Periods:





The Beef Margin calculation uses Feeder Cattle futures to price inbound animals and assumes each will consume 55 bushels of corn and cost approximately \$250 per head (for other feed and non-feed expenses) to gain 550 pounds and reach a market weight of 1,250 pounds.

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# Corn Margin Watch: May

Corn margins have declined since the middle of May as supply expectations continue to outweigh demand projections. Planting is virtually complete with many states seeding faster than average. The rapid seeding pace reduces the expectation of Preventative Planting acres this year and would be one less bullish factor for prices. Crop conditions have been reported to be 74% in good-to-excellent condition, slightly above average for late May. Planted acres will be finalized at the end of the month reported by NASS in the Acreage report. On the positive side, due to normal spring weather and below average profitability, there is no expectation of any major upward adjustment to final acres currently. On the demand side, export sales are running at 93% of the USDA expectation compared to 92% on average for this point in the crop year. Shipments are a little slower amounting to 67% of the expectation compared to 72% on average. The long-awaited EPA decision on biofuel volume requirements has finally come with the EPA proposing minimum ethanol production volumes for 2014, 2015 and 2016 at 13.2, 13.4 and 14.0 billion gallons respectively. The numbers came in near market participant expectations and are disappointing for the corn and ethanol industries. The mandate, albeit reasonable based on today's demand for ethanol, offers little growth beyond the blend wall. An increase in the fuel standards beyond the 10% blend wall is required to increase corn use to produce ethanol. The USDA did say they would invest up to \$100 million in grants for fuel pumps to distribute higher ethanol blends like E15 and E85. While a good step longer term, the decision does little to help change the balance sheet today. Market prices continue to limit opportunities to protect attractive forward margins. Our consultants are working with clients to help make strategic adjustments to existing protection strategies to help improve margins over time. Producers continue to favor flexible strategies that would protect all lower prices while still preserving the opportunity to benefit should prices rise.



The estimated yield for the 2015 crop is 174 bushels per acre and the non-land operating cost is \$615 per acre. Land cost for 2015 is estimated at \$238 per acre<sup>1</sup>. Basis for the 2015 crop is estimated at \$-0.06 per bushel.



The estimated yield for the 2016 crop is 174 bushels per acre and the estimated operating cost is \$615 per acre. Land cost for 2016 is estimated at \$238 per acre<sup>1</sup>. Basis for the 2016 crop is estimated at \$-0.2 per bushel.

<sup>1</sup> The Corn Margin Watch yield, land and non-land operating cost values are based upon central Illinois low productivity farmland crop estimates in the "Historic Corn, Soybean, Wheat, and Double-crop Soybeans" report published by the Department of Agricultural and Consumer Economics at the University of Illinois.

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Soybean margins have weakened further since the middle of May as the USDA projects near-record soybean stocks for the coming year. The seeding pace has been slightly ahead of average this year with the exception of a few Plains states and should be wrapped up in the next few weeks. Crop conditions will be reported once 50% of the crop has emerged. Good corn conditions thus far imply the bean start should be equally as good. Planted acres will be finalized at the end of the month reported by NASS in the Acreage report. On the negative side, many market participants expect a larger seeded acreage number due to below average profitability in corn. On the demand side, export sales for beans have continued to show up and currently represent 101% of the USDA expectation compared to 97% on average for this point in the crop year. The shipment pace is also ahead of the average needed to meet the forecast at 95% shipped versus 89% on average. The long-awaited EPA decision on biofuel volume requirements has finally come with the EPA proposing minimum biomass diesel volumes for 2014, 2015 and 2016 at 1.63, 1.7 and 1.8 billion gallons respectively. The numbers came in above market participant expectations causing a strong price rally in soybean oil. The EPA's proposal has entered a comment period and will need to be signed into law from Congress by November. Opportunities to protect attractive forward margins remain limited. Our consultants are working with clients to evaluate current protection strategies and make adjustments while weighing the costs and benefits. Some of our clients that previously decreased the delta of hedges to capitalize on the lower market continue to consider similar adjustments to a greater percentage of coverage that would benefit should the market move higher while still maintaining protection to all lower prices.



The estimated yield for the 2015 crop is 52 bushels per acre and the non-land operating cost is \$365 per acre. Land cost for 2015 is estimated at \$238 per acre<sup>1</sup>. Basis for the 2015 crop is estimated at \$0.2 per bushel.



The estimated yield for the 2016 crop is 52 bushels per acre and the estimated operating cost is \$365 per acre. Land cost for 2016 is estimated at \$238 per acre<sup>1</sup>. Basis for the 2016 crop is estimated at \$-0.2 per bushel.

<sup>1</sup> The Soybeans Margin Watch yield, land and non-land operating cost values are based upon central Illinois low productivity farmland crop estimates in the "Historic Corn, Soybean, Wheat, and Double-crop Soybeans" report published by the Department of Agricultural and Consumer Economics at the University of Illinois.

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Wheat margins have deteriorated since the middle of May as weather concerns fade. On the domestic front, export sales continue at a slow pace with 126 million bushels sold, down 24 million bushels from last year's tepid pace. Although prices have fallen sharply of late, U.S. export offers remain uncompetitive compared to Black Sea and E.U. offers. Spring wheat plantings are virtually complete with crop conditions showing a favorable start. The latest crop progress report rates the spring crop 69% in good-to-excellent condition, up 4% from the previous week. Winter wheat harvest should begin in the coming weeks which will put further pressure on nearby values. Weather forecasts show a lasting period of mild and dry weather conditions in the Plains giving farmers a good window to reap the winter crop. On the world front, improving weather forecasts in the Black Sea region have alleviated concerns. Russia has also introduced a floating export tariff beyond July 1, which would be a function of F.O.B. cash prices. A minimum tax of \$1/MT will be placed on exported wheat. Otherwise, new fundamental information remains absent with the domestic marketplace searching for demand drivers. Our consultants continue working with clients to protect these forward margins with flexible strategies on existing coverage that will allow for potential margin improvement over time. Some of our clients that previously decreased the delta of hedges to capitalize on the lower market have been rewarded by making the adjustments. Some of our clients continue to consider similar adjustments to a greater percentage of coverage that would benefit should the market move higher, while maintaining protection to all lower prices.



The estimated yield for the 2015 crop is 67 bushels per acre and the non-land operating cost is \$366 per acre. Land cost for 2015 is estimated at \$163 per acre<sup>1</sup>. Basis for the 2015 crop is estimated at \$0.03 per bushel.



The estimated yield for the 2016 crop is 72 bushels per acre and the estimated operating cost is \$328 per acre. Land cost for 2016 is estimated at \$158 per acre<sup>1</sup>. Basis for the 2016 crop is estimated at \$-0.05 per bushel.

<sup>1</sup> The Wheat Margin Watch yield, land and non-land operating cost values are based upon central Illinois low productivity farmland crop estimates in the "Historic Corn, Soybean, Wheat, and Double-crop Soybeans" report published by the Department of Agricultural and Consumer Economics at the University of Illinois.

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