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INSIDE THIS ISSUE

Margin Watch Reports

Features

Dear Ag Industry Associate,

2014 may well be remembered as "the year of protein" as we have seen significant moves higher in the dairy and livestock sectors. Cattle prices have been on a tear for some time now due to the lower supply of available animals following years of drought in the Southern Plains. Hog prices have likewise moved sharply higher on supply fears as PEDv has taken a toll on domestic herds and clouded the picture of future pork production. Milk prices continue to maintain lofty levels as the weather has not fully cooperated with advancing production through the spring flush while demand for dairy products remains strong.

While the higher protein prices are certainly welcome to livestock producers and dairies that are currently enjoying strong profit margins, there is no doubt concern about locking in prices and missing out on opportunity in these sharply rising markets. This edition of Margin Manager explores that topic with a focus on the importance of maintaining flexibility. While written from the perspective of a cattle feedlot, this certainly applies to the dairy and hog production industries also.

In addition, we also address another topic that crosses these industries as well, which is how a producer chooses to manage their corn when they actually grow it for their livestock operation. With corn dropping sharply in price, many livestock producers with crop operations have grown increasingly concerned with the deteriorating value of their corn, and we discuss the various ways that the corn price can be managed within a margin context for those operations.

We also sat down this month with Mike Moroney, leader of our beef service team, who provides insight on the challenges that feedlots are facing in the current environment trying to manage forward profit margins. Finally, the latest set of Margin Watch reports update the profitability outlook for all of these industries in light of some major recent reports, including the USDA's Quarterly Hogs & Pigs, Grain Stocks, and revised Acreage.

Sincerely,

Chip Whalen
Managing Editor
V.P. Of Education & Research
CIH

Upcoming Margin Management Seminars

Beef, July 8-9

Crop, July 9-10

Hog, July 23-24

Dairy, Aug 20-21

Managing Editor, Chip Whalen is the Vice President of Education and Research for CIH, a leader in Margin Management. Over the past 15 years, Mr. Whalen has lectured extensively throughout the country, introducing agricultural lenders, producers and industry associates to the margin approach to risk management. He has also written articles for many leading agricultural publications.

Written by Chip Whalen, Managing Editor

The Importance of Maintaining Flexibility

Beef cattle producers unfortunately are not enjoying the same degree of profitability as their companion industries in the dairy and swine sectors. While feed costs have moderated amidst a backdrop of soaring protein prices, feedlots find themselves on both the purchase and sale side of cattle having to bid up for feeder supplies in the open market. Due to the impact of drought over the last few seasons in the Central and Southern Plains, feeder cattle supplies have dwindled and costs have skyrocketed. As a result, while cattle prices and feed costs have moved in opposite directions, much of the positive impact to margins has been muted since feeder cattle costs are rising faster than fat cattle prices. This presents a significant challenge for feedlots trying to manage forward profit margins as they may face a loss or breakeven scenario at best once the cattle enter the feedlot.

While live cattle prices have not been keeping up with the strength in the feeder market, both markets have been printing all-time high prices recently in response to the strong demand for beef. For the time being, it appears that consumers are willing to dig deeper in their pockets to pay up for protein. This has helped to support not only beef prices, but pork and dairy product values as well. Although this is certainly a positive dynamic from the standpoint of forward profitability, it also carries with it a high degree of risk should the demand begin to weaken over time. While a feedlot may have diminished power at auction to control feeder costs in the current environment, they do have more control over how they choose to manage the other legs of their profit margin.

> *"If the strategy is to do nothing until I have greater visibility in my forward production, I may very well miss opportunities to protect favorable margins being projected by the market."*

Consider fat cattle prices. Let's assume I am placing cattle today in my yard which will be marketed to a packer 6 months from now against the February futures contract at the CME. The February futures price is right around $152/cwt. currently, about $2.00 below its life-of-contract high. While conventional wisdom might dictate to simply sell futures into this rally, the reality is that projected profit margins are currently negative so this would effectively lock my feedlot into a loss for the period. As an alternative, I might instead consider placing a floor under my cattle by purchasing a put option. The right to sell February 2015 Live Cattle futures at a price of $152/cwt. is currently valued at a cost of around $4.00/cwt. By purchasing this right, I establish a floor under my fat cattle for this marketing period at $148, which was the life-of-contract high as recently as 2 weeks ago. The chart on the following page diagrams this strategy for the February futures contract.

February 2015 Live Cattle Futures Chart:

Assuming I purchase the put option, ideally the market would move higher over time so that my projected profit margin improves and I have the opportunity to capture a positive margin by making an adjustment. As a worst case scenario, if the market instead moves lower, I at least know that I have established a floor underneath the value of my finished cattle. While that would represent a loss for this particular marketing period, it would at least be a defined loss at that point holding my feed costs constant. The alternative, of staying open to the market on the value of my finished cattle, would present the possibility of an undefined loss which might be catastrophic if the demand picture changes between now and next winter.

Getting back to the more optimistic scenario, I would ideally like to see the live cattle market move higher after purchasing the put option so that I have the opportunity to make an adjustment. How exactly does this work? One way to evaluate the potential benefit of making an adjustment to this position is to consider the cost. If I am spending $4.00/cwt. to purchase the put option in this particular example, I would want to see the February futures price rise by at least that much before I would begin considering an adjustment. From a cost standpoint, the most I can lose on the put option is the premium paid for it; therefore, I would want to benefit by at least that much by retaining the opportunity to participate in higher prices. This means that if I pay $4.00 for the right to sell February Live Cattle futures at $152.00, I would want to see the February futures price be above $156.00 at a minimum before considering an adjustment.

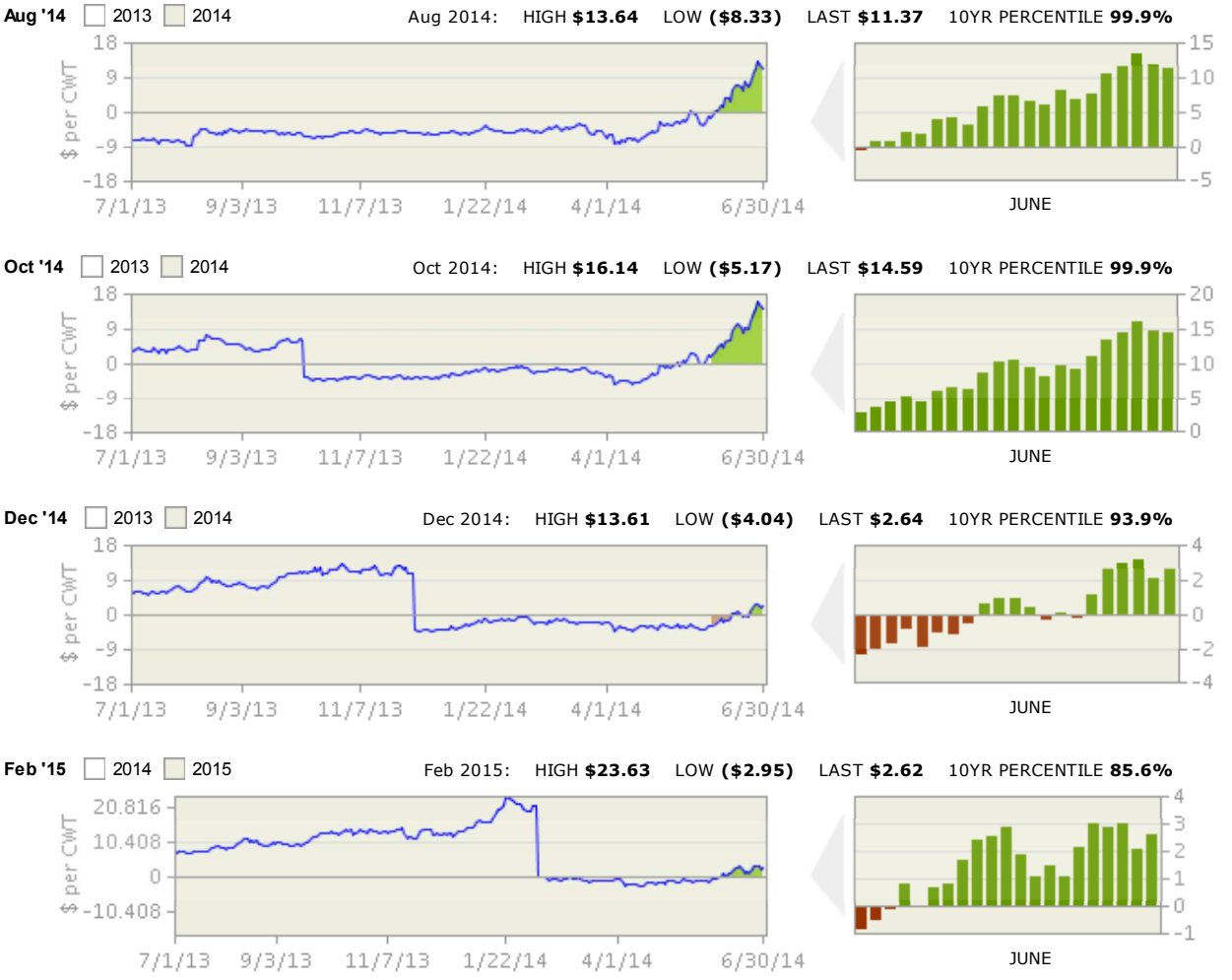
At that point, there are a few potential alternatives I could consider. The simplest one would be to offset

Continued on Page 6

Beef Margin Watch: June

Beef margins were mixed since the middle of June, improving sharply in nearby marketing periods where feeder cattle are already purchased, but deteriorating in deferred slots where feeders are not yet placed. As has been the case for some time, strength in the feeder market has more than offset higher live cattle prices such that the impact on margin has been negative. One supportive element though is sharply lower projected feed costs following bearish USDA month-end data. USDA reported June 1 corn stocks of 3.854 billion bushels, 130 million above the average trade guess and 39% higher than last year. The figure implies much lower feed demand during the March-May quarter, and suggests USDA will raise old-crop ending stocks as a result in the July WASDE report. Corn acreage meanwhile was revised down 50,000 acres from the March Planting Intentions to 91.641 million which was slightly below the average trade guess but well within the range of estimates. Beef prices have been supported by continued tightness in fed cattle supply with recent Cold Storage data indicating strong demand. USDA's latest report showed total beef in cold storage on May 31 at 378.9 million pounds, down 5.8% from April and 21.5% below last year. Meanwhile, the latest USDA Cattle on Feed report showed the on-feed inventory as of June 1 at 10.594 million head, down 1.6% from last year vs. the average of pre-report estimates expecting a 1.7% decline. May cattle placements of 1.912 million head were also very close to expectations as they came in down 7% from last year when analysts on average were expecting a 7.4% decline. Our clients are focusing on nearby placement opportunities against the February marketing period with flexible strategy alternatives that can benefit from further margin improvement. In addition, strengthening existing feed hedges also looks attractive following the recent weakness in corn.

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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175 W. Jackson, Suite 1760 ▪ Chicago, IL 60604 ▪ 312-596-7755

Continued from Page 3

the put option, salvage any residual value remaining in the option, and lock in a sale price by selling a futures contract. I could evaluate this adjustment by looking at what the net price would be that I am locking myself into at that point. If the market moves higher, there will be a loss on the put option that I will have to subtract from my sales price on the futures contract. I had the ability to sell futures at $152.00 when I initially purchased the put option, so at a minimum, I would want my net price to be above this level. I also have to consider my overall profit margin. I purchased the put option to retain the opportunity to realize a positive margin over time. What would my margin be given a net sales price at this level? If I am not realizing a positive margin, I probably would not want to lock in a futures price yet.

As an alternative, perhaps there is a target futures price that would represent an acceptable sale price and profit margin for this group of cattle. I might consider selling a call option which would obligate me to this sale price should the market continue rising. I would receive a premium for selling the call option, which I could in turn use to help re-establish my floor at a higher level. This would entail selling the put I currently own at $152, and replacing it by buying a put at a higher strike price. As an example, if February Live Cattle futures are now trading at $156.00/cwt., I might consider selling a call option for instance at $162, and using those proceeds to roll up my put from the $152 to $156 strike price. In this way, instead of having a floor at $152 for a $4.00 cost, I would now have a floor at $156 and a ceiling at $162 for the net price of my original $4.00 cost plus any additional expense related to the adjustment. Depending on option prices at the time of making this adjustment, there may not be any additional cost at all, as the premium received from selling the call option may completely pay for the cost of rolling the put to a higher strike price.

While we have not discussed the feed side of the margin equation, this too would also represent an area where I might improve upon my price and margin over time by maintaining flexibility. As opposed to locking in a corn price at current levels, I may consider establishing a ceiling or maximum price on my feed by purchasing a call option. In a similar way, I would look for the opportunity to improve upon my margin through declining feed costs over time. I would consider adjustment opportunities to either lock in a lower corn purchase price by buying futures, or rolling down my call option in a declining market. Like the cattle example, I might consider paying for this by accepting a price at which I would be willing to buy futures, and receive a premium by selling a put option. However I choose to approach it, the current environment in the beef cattle market demonstrates the value of remaining flexible with a feedlot's margin management decisions. ■

"However I choose toapproach it, the current environment in the beef cattle market demonstrates the value of remaining flexible with a feedlot's margin management decisions."

NEXT SEMINAR

Beef Margin Management
Kearney, Nebraska
July 8-9

Q&A Answering questions about margin management

Written by Michael Liautaud, Editor

What if I Feed my Own Corn?

As a general note, declining feed prices have been a boon for the livestock industry and come as welcome relief from the last several years of limited supplies due to drought and soaring demand from the export market and ethanol industries. While not all livestock producers have benefited to the same degree depending on their particular feed rations, lower costs generally have translated into improved margins for livestock producers. Hay availability remains limited and costs high for dairy producers while soybean meal prices likewise have maintained historically high prices due to strong export demand and short old-crop soybean supplies. Corn prices, however, have come down substantially from a combination of demand pressure and expectations for sharply increased supplies this season. While it is still early, weather has been quite favorable for the corn crop's development, and many people are openly discussing the possibility of above-trend yield potential. Meanwhile, China has been in the news recently for halting DDG imports due to concern over contamination with MIR-162, a GMO strain not yet approved in the country. There is also concern that their corn stocks are much larger than current USDA estimates, and this may further limit future demand from the country.

Although lower corn prices are certainly welcome for many livestock producers, what about those operations that actually raise their own corn? Looking at the corn situation strictly from the perspective of a crop producer, margins are presently negative at current price levels. In other words, if I simply grow corn as a crop farmer and do not finish livestock, I am projected to lose money on this year's harvest. Assuming I do raise hogs, finish cattle or milk a dairy herd, I may very well be realizing a profit on these animals given my cost of

Continued on Page 8

Continued from Page 7

production on corn, but how do I handle this cost in light of the fact that current corn crop margins are negative? This is not an easy topic to address, although it brings up an important distinction in how a livestock operation evaluates their forward profit margins and how they approach their risk associated with those margins.

If I finish hogs, cattle, or milk dairy cows and also grow my own corn, there are two ways that I may choose to look at my operation. First, I may consider the crop and livestock operations as separate businesses and manage them independently. This may very well be the case if there is a different ownership structure between the two units. As an example, my wife and I may own a farm where we have a row-crop operation producing corn and soybeans. Separately, my brother and I might go into business together and invest in finishing barns to raise hogs. In this case, the decision to manage them separately will be fairly straightforward as each business will have its own tax ID and keeping the financials independent of one another will be important.

In other cases, both the crop and livestock operations may have the same beneficial ownership which will make it more complex. In this case, I have a choice of how I want to treat the crop entity. I can either run it as an independent business with its own profit and loss, or I can treat it as a cost center for my livestock operation. In the former case, I will make marketing decisions on my corn independent of the needs of my livestock operation. In the latter case, the crop production exists to accommodate the feed needs of my livestock herd, and I essentially account for it at my cost of production. In either case, the corn is assumed to never leave the farm; in other words, even if I were to treat them as separate businesses, I would never actually market the corn outside of the farm where I would need to replace the physical bushels for my livestock feed needs.

With this in mind, how I make my crop marketing decisions becomes more complex if I choose to run them as separate businesses. Even though the corn will never leave the farm, the point at which the crop entity may want to sell the corn will probably not coincide with when the livestock entity wants to purchase that same corn for feed. Their interests are opposed as the crop entity is trying to sell the corn as high as possible while the livestock operation is trying to buy the corn as low as possible. If I treat my crop operation as a cost center to my livestock, in a case such as the past few years where the replacement cost of corn is above my cost of production, I am penalizing the crop farm and subsidizing the livestock. In a scenario like the one playing out in the current year, I may find that I am raising my corn crop for more than the replacement cost in the open market such that the crop farm will break even but there is an opportunity cost to the livestock operation.

Ideally, I would like to maximize the return for each business without creating a burden on one or the other. In doing so, I will need to be careful with the types of strategies I use to manage my margin for each operation. The pitfalls with running the crop farm as a cost center were previously outlined. If I simply feed my corn at its cost of production, one of the operations is losing out depending on whether the market price of corn is above or below my cost of production. If I run them separately and manage the strategies for each operation independent of one another, I still have to give consideration to how margin management decisions on one operation impacts the other.

As an example, let's assume that I am running them separately and looking at my corn crop margin specifically. Corn is trading at $6.50/bushel which is currently $2.00 above my cost of production assuming I produce trendline yields based on my average production history. Because $2.00 represents a tremendous margin opportunity for the crop operation from a historical perspective, I decide to lock this in by selling a futures contract to set the $6.50/bushel sale price. At

Continued on Page 10

Corn Margin Watch: June

Corn margins have deteriorated sharply since the middle of June as larger expected supplies loom. NASS recently reported Quarterly Grain Stocks in all positions revealing corn supplies at 3.854 billion bushels. This implies usage of 3.15 billion bushels through the third quarter or 23.1% of annual usage, on par with the 5-year average. The stocks number was seen in a bearish light as market participants were looking for an additional 130 million bushels used through the period. NASS also reported an update on Planted Acreage for this year at 91.641 million acres planted, down 50,000 acres from the March estimate. Harvested acres are estimated at 83.839 million acres, down nearly 500,000 acres from the June WASDE report. While lower planted and harvested acres are supportive to prices on the face, participants were looking for even fewer acres seeded to corn in favor of other crops. Current crop conditions have been reported to be 75% in good-to-excellent condition with the crop only a few weeks away from the critical pollination period. Given the ideal conditions and seasonal forecasts, market participants have been discussing the prospect of above-trend yields come harvest. While not there yet, the prospects of record supplies remain on the table. On the demand side, usage for feed continues to fall short of logical levels given the strength of forward livestock margins. However, with hog and cattle inventories well below year-ago levels, feed demand has suffered. Barring any drastic demand shifts, weather will remain the focus throughout pollination. Nearby corn margins are currently at the 19th percentile of the last five years while deferred 2014 corn margins are at the 18th percentile. Our consultants are working with clients discussing margin protection of these forward values, particularly in the New Crop position, maintaining flexibility with strategy alternatives. Given that the market has continued to fall, some of our clients continue to consider adjustments to current coverage that would create a range of protection to lower prices with consideration to crop insurance levels while preserving the opportunity for margins to improve in the event prices move higher.

The estimated yield for the 2014 crop is 183 bushels per acre and the non-land operating cost is $638 per acre. Land cost for 2014 is estimated at $240 per acre [1]. Basis for the 2014 crop is estimated at $0.2 per bushel.

The estimated yield for the 2015 crop is 180 bushels per acre and the estimated operating cost is $612 per acre. Land cost for 2015 is estimated at $243 per acre [1]. Basis for the 2015 crop is estimated at $-0.1 per bushel.

[1] *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.*

Continued from Page 8

the same time however, $6.50/bushel does not represent a good purchase price for my cattle feeding operation. Moreover, let's also assume that I do not have a margin opportunity that looks attractive against this same new-crop corn so there is no upside protection in place against the feed needs of these cattle.

Now consider a scenario where corn continues to increase in price to $8.00/bushel as has happened in past years. On the crop side, I am already locked into a sale price of $6.50/bushel. That entity is not participating in any improved margin opportunity resulting from higher prices on the open market. At the same time, the cattle operation remains open on their feed needs which are becoming more expensive on the open market. Both operations are now worse off as a result. A better approach may be to coordinate the strategies between the two entities. In the above example, I may choose to sell futures for my crop operation without consideration for the needs of my feedlot if I am considering that alternative in isolation. This may very well be a sound hedging decision given the $2.00/bushel profit margin being projected, but it may not be the best decision in light of the fact that I do not have feed protection in place for my cattle herd. In this case, I may choose to put a floor under the value of my corn to protect the crop entity's profit margin, while leaving flexibility in place to allow for higher prices.

As another example, let's assume the same feedlot is looking at a margin opportunity for placing cattle in the current year, and decides that $5.00/bushel corn translates favorably for a projected return on a group of cattle. On the crop side, the same $5.00 corn may be at or below a breakeven cost of growing that corn such that there is not a margin opportunity for the crop entity. If the feedlot entity protects their margin by purchasing a corn futures contract while the crop operation has no protection to lower prices in the open market, a situation such is currently playing out where corn declines in price to $4.50 means that the crop entity's margin is now further in the red where the feedlot has also lost out on the opportunity to participate in more favorable prices.

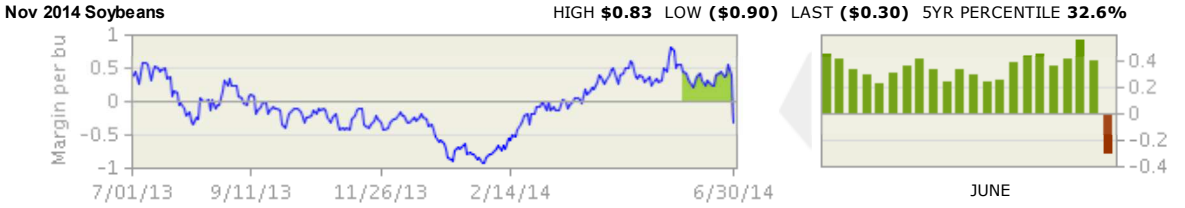
"If I am growing my own corn and choosing to treat my livestock feeding business and crop production operation as separate entities, I need to be mindful of how contracting decisions for one impacts the other, and coordinate my strategies between the two"

In both cases, the need for increased flexibility becomes pretty clear. If I am growing my own corn and choosing to treat my livestock feeding business and crop production operation as separate entities, I need to be mindful of how contracting decisions for one impacts the other, and coordinate my strategies between the two. In revisiting the prior examples, where selling corn futures at $6.50/bushel may have represented a sound decision for the crop entity from a margin standpoint, buying a call option at the same time for the cattle feedlot would have been a prudent supplemental strategy to address the risk of higher prices for both operations. In the second example, where buying futures may make sense for the feedlot in light of their margin opportunity, purchasing a put option at the same time for the crop entity to address the risk of lower prices for both businesses also would have been a sound decision. This may require increased management and greater coordination among those involved in the decision making process, but in the end will likely result in improved margin management success over the long run. ■

Soybeans Margin Watch: June

Soybean margins deteriorated since the middle of June, particularly for deferred periods in the New Crop position. NASS recently reported Quarterly Stocks in all positions at 405 million bushels versus expectations of 389 million bushels remaining for the 2013/14 crop. This implies usage through the third quarter of 589 million bushels or 17.3% of expected annual usage compared to 20.9% on a 5-year average. While still historically tight, the slightly higher quarterly stocks figure takes some pressure off the old crop situation. NASS also reported an update on Planted acreage for this year at 84.839 million acres planted and 84.058 million acres harvested, up roughly 3.3 million acres from the March expectation. The larger planted area was the driving force to lower margins over the period. Current crop conditions have been reported to be 72% in good-to excellent condition which is the best conditions on record for this point in the crop year. While the soybean crop is not made in June, the elevated conditions have market participants expecting no worse than trendline yields provided normal August weather. On the demand side, old crop tightness has begun to crack with the recent news that China has banned any imports of GMO DDGs. The ban has created surpluses domestically and has DDG prices falling sharply enough for some livestock producers to consider substituting DDGs in the protein part of rations. Nearby soybean margins are now at the 71st percentile of the last five years and deferred 2014 soybean margins are now at the 32nd percentile. Our consultants are working with clients to manage these forward profit margins. Given that new-crop margins have fallen sharply, some of our clients are considering flexible margin protection strategies on any new coverage as well as adjustments to current protection strategies that would provide protection to all lower prices while retaining the flexibility to participate in higher margins should prices improve.

The estimated yield for the 2014 crop is 53 bushels per acre and the non-land operating cost is $330 per acre. Land cost for 2014 is estimated at $240 per acre [1]. Basis for the 2014 crop is estimated at $0.25 per bushel.



The estimated yield for the 2015 crop is 52 bushels per acre and the estimated operating cost is $364 per acre. Land cost for 2015 is estimated at $243 per acre [1]. Basis for the 2015 crop is estimated at $-0.2 per bushel.

[1] 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.

Wheat Margin Watch: June

Wheat margins continued to deteriorate through the remainder of June as global surpluses remain. NASS recently reported final stocks for the 2013/14 wheat crop to be 590 million bushels, 3 million bushels below last month's WASDE. NASS also reported an update on planted acreage for this year, upping spring wheat acres 700,000 from the March estimate. The majority of expansion of acres occurred in Montana and South Dakota. Harvested acres were also raised to 12.4 million which would suggest a Hard Red Spring wheat crop 40 to 50 million bushels larger than last month's estimate. Spring wheat crop conditions remain favorable with 70% of the crop currently in good-to-excellent condition. Adding to price pressures has been lower corn values on larger expected supplies which will continue to displace any wheat demand in livestock rations. On the global front, supplies are expected to swell in all major producing countries as world weather conditions are ideal. European and Russian offers for spot and deferred supplies have continued to move lower daily as excess supply is currently projected. U.S. wheat prices are on par with foreign offers at present. Nearby wheat margins are now at the 18th percentile of the past five years with deferred 2014 wheat margins now at the 26th percentile. Our consultants continue working with clients to protect these forward margins with flexible strategies that will allow for potential margin improvement over time. Given the continued weakness in futures' prices, some of our clients are considering adjustments to current protection strategies that would protect a range of lower prices while still preserving the opportunity to participate in higher prices should the market rebound.

The estimated yield for the 2014 crop is 67 bushels per acre and the non-land operating cost is $360 per acre. Land cost for 2014 is estimated at $150 per acre [1]. Basis for the 2014 crop is estimated at $0.3 per bushel.

The estimated yield for the 2015 crop is 67 bushels per acre and the estimated operating cost is $366 per acre. Land cost for 2015 is estimated at $163 per acre [1]. Basis for the 2015 crop is estimated at $-0.05 per bushel.

[1] 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.

Interview with Beef Margin Consultant, Mike Moroney

What are the biggest risks facing cattle feeders today?
There is an enormous amount of risk involved in paying $215 for a feeder against a 160 breakeven. The spot feeder cattle price has gone up by 61% in 12 months. This rally that we've seen in both the feeder cattle market and the live cattle market has allowed for some balance sheet repair after two very tough years. But markets don't move in one direction forever, and at these price levels a continuation to still-higher prices is not a certainty. So, when it eventually turns – whether that is three months, six months, 18 months, no one knows. But when it does there will be a lot of pain out there for feedlots full of feeders that aren't protected with hedges (whether that be options or futures based). The risk of equity destruction is large should the live cattle market correct sharply.

Also, it's important to consider that even after this huge rally in live cattle, for many producers a placement for August at $215 would require a $160 live cattle market. The board is trading $5 below that level. Thus, maintaining flexibility is crucial.

How does a feeder manage the risk when they have to pay a 61% premium year/year ($215) to place cattle?
It is a difficult challenge but the objective is to meet two goals for the cattle that you place. First, protect your equity. That is imperative at these levels. For any cattle that clients are placing, we have been exploring a variety of strategies, but at a minimum having a put spread against all of their production. Implied volatility is extremely low relative to the moves we've seen.

"... So, when it eventually turns – whether that is three months, six months, 18 months, no one knows. But when it does there will be a lot of pain out there for feedlots full of feeders that aren't protected with hedges..."

Second, cattle producers should maintain some flexibility so that if this market keeps moving they can participate. We want protection so we are inclined to buy puts. We also want to give our clients the opportunity to participate in this run so we have been selling calls or selling futures only after a significant move from the price live cattle were trading at placement.

Does using the feeder cattle contract on the board make sense?
Yes. It accomplishes a few goals. Where a client has an opportunity that pencils out close to a breakeven, it can act as a legitimate hedge versus waiting until the time where you are going to place the cattle and wait to see what the market offers. It also allows a feedlot operator to express a bullish or bearish bias by using options to hedge that

Continued on Page 14

Continued from Page 13

position. If the market moves sharply in one direction then you are hedged on one side and relatively open on the other.

What has been CIH's approach in using the fc contract?
One of the guys on our business development team, Bo Kizziar has been doing a terrific job hypothetically managing beef margins using some of our basic methods. He publishes his work twice a month in an email blast called, "Bo's Notes." I highly recommend that to cattle producers who are new to the margin approach to risk management.

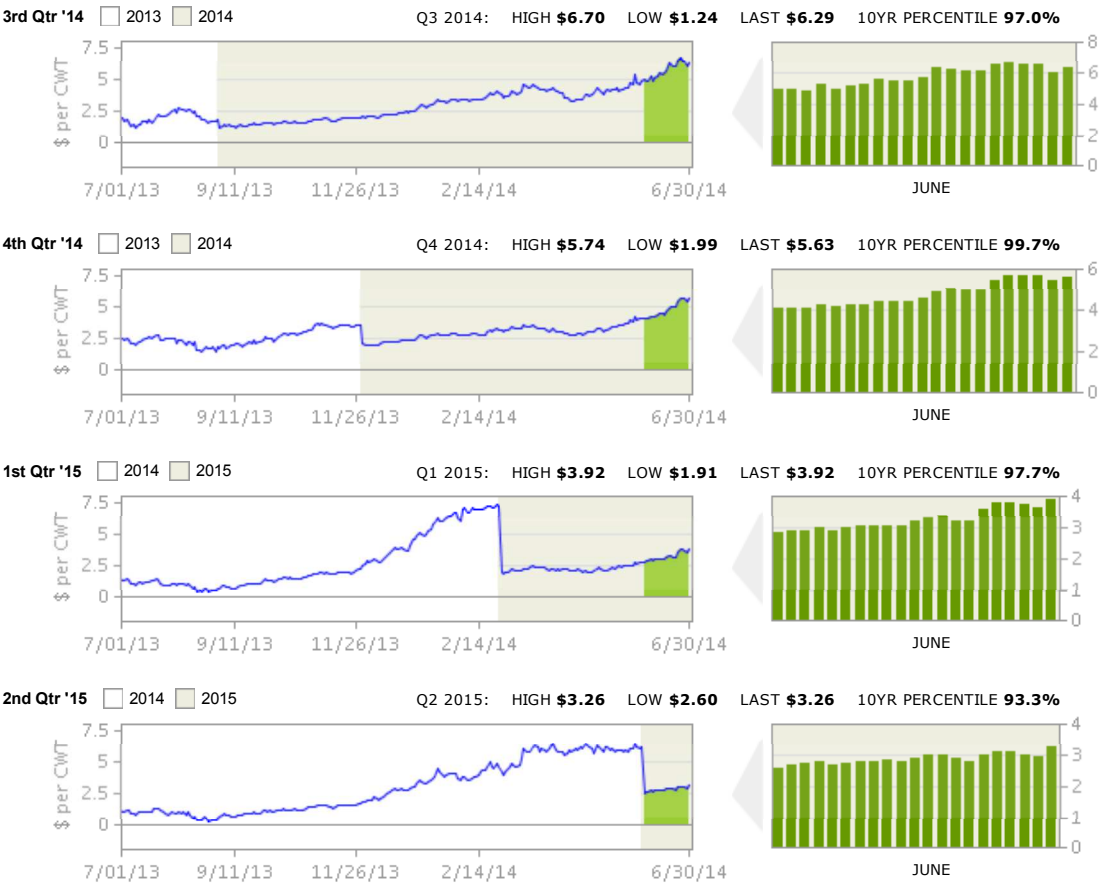
Running Bo's model, we've been primarily starting with futures or options in feeders and primarily using puts and put spreads on fats. That has worked out great.

What about basis when placing against those hedges?
Primarily, hedge gains from using flexible strategies have more than offset the basis risk.

After the run we've seen, are you still taking the same approach?
Fundamentals are still tight. Demand for beef is strong. Most clients are still using options for live cattle hedges and setting targets to firm up hedges. For forward placements using the fc contract, we are starting to implement strategies that are more option-based. There are clients who feel that this fc market has gotten ahead of itself and are buying calls on the fc side and buying puts on the lc side. Their thinking is that if both markets move lower, they can price feeders much below current levels yet have a floor established on the live side with puts. And as always, we are analyzing the corn market closely and structuring a variety of hedge strategies to fit our clients' feeding hedge needs. ■

Dairy Margin Watch: June

Dairy margins moved sharply higher to finish the month of June, supported by a combination of higher milk prices and lower corn and meal costs. Forward margins remain extremely favorable from a historical perspective, at or well above the 90th percentile of the previous 10 years deep into 2015. Milk futures have been supported by a strong butter market, with spot values at the CME now at $2.50/lb. USDA's Cold Storage report showed May 31 butter stocks at 192.5 million pounds which was up 10.6% from April but down 40.2% from last year. U.S. May milk production was reported at 18.055 billion pounds which was up 0.3% from April and 1.4% higher than last year. The report also reflected a larger milking herd, with 10,000 cows added in May to a 2-year high of 9.252 million head. The milking herd has grown by 54,000 head since November, and milk production may expand more quickly with improved weather and new hay supplies improving forages – particularly in the Upper Midwest. USDA released their June acreage and quarterly stocks reports which were decidedly bearish for corn and soybeans in particular. June 1 corn stocks of 3.854 billion bushels were 130 million above the average trade guess, and implied much lower feed usage in the March-May period than the market was expecting. Soybean acreage meanwhile was revised up 3.3 million from the March Planting Intentions to 84.839 million, well above the average trade estimate as well as outside of the range of estimates. Both the corn and soybean meal markets were sharply lower in response to the data. Our clients continue scaling into margin protection in deferred periods with flexible strategies, while evaluating opportunities to make strategic adjustments on existing positions. Strengthening feed hedges looks particularly attractive right now following the USDA report.



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.

Hog Margin Watch: June

Hog margins soared to end the month of June following two key USDA reports. The Quarterly Hogs & Pigs report showed all hogs and pigs as of June 1 at 95% of a year ago compared to the average trade guess of 97.3% of last year, and the range of forecasts between 96.0-98.9%. In particular, traders focused on the lighter weight categories which seemed to ignite the market. The March-May pig crop was pegged at 95% of last year vs. an average trade guess of 97.7% and the range of estimates between 95.7-99.9% of 2013. Hogs weighing under 50 lbs. and those in the 50-119 lb. weight range were both estimated at 94% of last year when on average traders were looking for figures at 98.5% and 96.9% of 2013, respectively. Notwithstanding the weights at which those hogs will come to market, the numbers would point to lower supply in the mid-August to mid-November timeframe. Taking into account the options market today, hogs settled about $5.60 above Friday's close in the December and February contracts with October up $4.80/cwt. The USDA quarterly grain stocks report reflected larger June 1 corn and soybean stocks relative to pre-report trade expectations, and the soybean acreage figure was particularly bearish. Corn stocks of 3.854 billion bushels implied lower feed usage during Q3 than the market anticipated, while soybean stocks at 405 million bushels imply a record negative residual which would suggest that last year's crop size was understated. Meanwhile, soybean acreage was pegged up 3.3 million from the March planting intentions at 84.839 million acres while corn area was down 50,000 acres from March at 91.641 million. Our clients continue to focus on new margin opportunities well into 2015 while evaluating strategic adjustments on existing positions. The recent increase in hogs and weakness in feed is allowing for hedges to be strengthened on both sides of the margin equation.

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.