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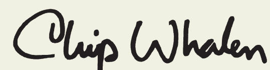
Dear agriculture industry associate:

2016 was a year that defied many expectations, both in agriculture and beyond. The Cubs finally won the World Series after a drought that stretched back to 1908. Donald Trump won the Republican nomination and the presidency, despite polls that overwhelmingly indicated a different outcome. In the world of agriculture, volatile crop and livestock margins provided surprises throughout the year as well. For hog producers, margins failed to gain much strength, barely staying above zero throughout the first half of the year before really deteriorating in the fall. In the dairy sector, it was the reverse; margins in the first part of the year rivaled the lows of 2009, but then a strong milk rally buoyed margins in the latter half. Cattle finishers are just now starting to see positive closeouts and a better outlook heading into spring marketing periods after a difficult year. Meanwhile, crop producers are faced with deeply negative margins following several years of well-above-average returns.

While every marketing period teaches agriculture producers something valuable about managing risk, the many surprises of the last year makes 2016 a particularly good instructor. Our feature article this month, “Lessons Learned from 2016,” aims to distill the events – both expected and unexpected – of the past year into maxims that can be useful for the future. In addition, our regular Margin Watch reports highlight changes in projected returns for the livestock and crop industries over the past month.

As always, if you have questions, please feel free to contact me.

Respectfully,



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Upcoming Education Events

Crop Margin Management
Chicago

January 11-12, 2017

Dairy Margin Management
Albuquerque

February 1-2, 2017

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Lessons Learned from 2016

As a new year begins, we take the opportunity to reflect on the past 12 months and learn from what happened in the markets. Below are four important lessons that 2016 taught (or reminded) us.

1. **Markets are still cyclical.**

   When margins are strong, it's easy to get complacent about managing margin risk and forget that the market moves in cycles. In fact, in an improving margin environment, fear of missing out on additional margin improvement may tempt people to forgo executing margin management strategies. But it's still true that "nothing cures high prices like high prices." Strong margins provide incentive for producers to expand their production – and weak margins signal producers to contract – pulling margins in the opposite direction. The lesson is to expect that what goes up will eventually come down, and to have ample coverage in place to protect your operation from the inevitable swings.

2. **Have a plan.**

   While it is easy to understand why cycles exist, it is much harder to predict when they will turn. For that reason, it is helpful to be proactive about managing margins with a sound and thoughtful plan. Your plan should provide guidance for the right action to take in a variety of margin environments and price situations to strike the right balance between protection and opportunity for your operation's specific goals and needs. Thinking through your alternatives in advance and from many different perspectives can remove a lot of fear and stress that can come with making important marketing decisions in a challenging or fast-changing environment. A plan can also provide you with greater confidence in the decisions you make, so you avoid second-guessing yourself.

3. **Hope for the best, but prepare for the worst.**

   The goal of margin management is not only to protect attractive profit margins, but also to reduce the effects of unfavorable markets. That's why a comprehensive margin management plan will include a contingency component. In addition to triggering coverage at certain margin levels that are attractive by historical comparison, your plan should provide guidance for minimum coverage in case margins never reach those levels. By addressing this worst-case scenario, you help protect your operation against potentially devastating losses.

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4. Volatility can be both friend and foe.

Many agriculture producers think of volatility in negative terms. To be sure, without a sound margin management strategy in place, big price swings can wreak havoc on cash flow and budgeting – and could even wipe out an operation. That's why the goal of most risk managers is to compress the volatility of returns. If the market moves against you, strategic hedging positions can reduce the negative effects by allowing you to get a more attractive price than the current market. By the same token, when the market moves in your favor, hedge positions may mitigate the net positive effect on your margins.

However, while the goal of margin management is to achieve more consistent returns, the reality is that volatility isn't all bad. In fact, for savvy margin managers, price volatility presents opportunities. Proactively managing both input costs and output prices means you have more than one way to protect your net margins. Each time prices change, you may have an opportunity to capture an incremental gain by making a position adjustment. Volatile markets with frequent and/or large price swings simply present more of these opportunities. Over time, thoughtful adjustments following market movements may allow you to achieve a better margin position, with stronger protection, more flexibility, lower cost or some combination of all three.

While no one knows when and how cycles will turn or prices will move, it is safe to say that market volatility is here to stay. When markets start to move, it makes sense to consider whether and what kind of strategic adjustment would help you get closer to your margin objective.

If you have questions or would like help incorporating these lessons into your margin management plan, please call 1.866.299.9333.

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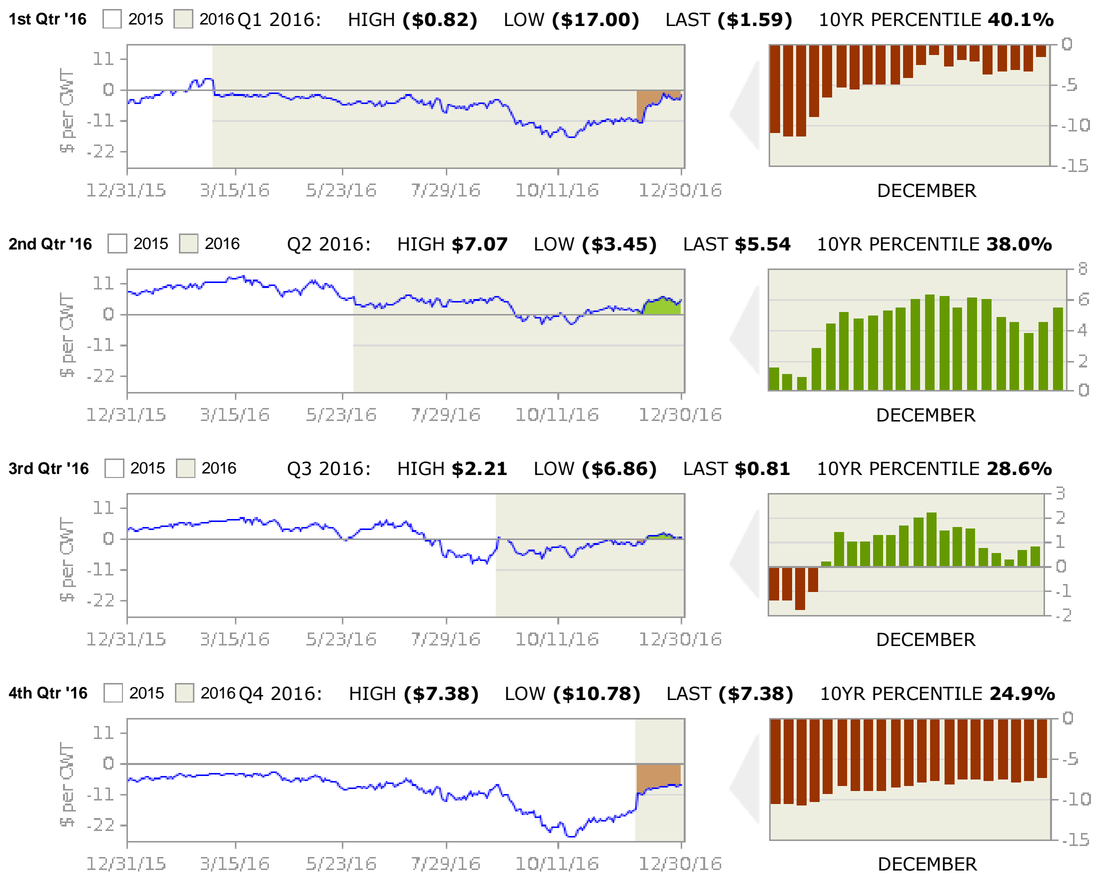
Hog Margin Watch: December

Hog margins were mixed over the second half of December, weakening in some marketing periods while strengthening in others. There was limited market movement during the period, with both feed costs and hog prices holding steady. Projected forward profit margins for 2017 are currently below average from a historical perspective, though positive for both Q2 and Q3. Hog prices remain supported by indications of stronger demand despite huge Q4 pork production. The market has also held up quite well in the face of what was considered a very bearish quarterly inventory report from USDA. The December Hogs and Pigs report reflected a significant upward revision in the Sep-Nov pig crop relative to pre-report expectations. Looking at the inventory numbers, hogs in the heaviest weight category (over 180 pounds) were up 2.5% from a year ago and in line with estimates; however, the lighter-weight categories of 120-179 pounds, 50-119 pounds, and under 50 pounds were up 4.0%, 4.5%, and 4.4% from last year, respectively. These figures were 2%-3% higher than industry expectations, and indicate much larger supplies for the late winter through spring marketing periods than previously expected. Moreover, the hog breeding herd as of December 1st at 6.09 million head was 1.5% higher than last year and also larger than expected. A continued trend of increased farrowings, along with growth in pigs saved per litter, could boost supplies through the summer and fall of 2017. On the feed side, both corn and soybean meal prices held relatively steady to finish the year, with traders looking to the upcoming USDA January WASDE report as well as developing South American weather, for further direction. Our hog producer clients continue to focus on adjustments to existing positions, particularly strengthening hog hedges following the recent USDA report.



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 were flat to stronger over the second half of December, with milk prices lower in nearby contracts and steady in deferred months, while feed costs remained largely unchanged. Margins are currently very strong from a historical perspective, at above the 90th percentile of the previous decade through Q3, while just below that threshold in Q4. Milk prices succumbed to pressure in nearby contracts following the latest USDA monthly Milk Production report, which indicated continued expansion. U.S. milk production totaled 17.1 billion pounds in November, up 0.6% from October and 2.4% from last year. USDA also reported a 17,000-head increase in the U.S. milking herd from 2015 to 9.339 million, which was also up 4,000 from October's figure. Productivity in the milking herd also rose with an above-trend 2.2% increase in milk production per cow during November. At the same time however, a drop in New Zealand milk production and a large drawdown in butter and cheese stocks in November helped to provide support. According to USDA's latest monthly Cold Storage report, butter stocks posted a record-large monthly decline in November of 67.3 million pounds, or 29.5% to 160.9 million, while cheese stocks in cold storage were 1.8 billion pounds. This was down 42.6 million pounds or 3.5%, from October, compared to an average monthly draw of 1.44% over the past 10 years. Meanwhile, feed costs have held relatively steady. The market is looking to the January WASDE report, which will include Quarterly Grain Stocks, as well as developing South American weather for further direction. Our dairy producer clients continue adding new margin coverage in deferred periods with flexible strategies that will allow for further margin improvement over time.

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 $8.00/cwt for non-feed expenses. Milk basis is $0.75/cwt and non-milk revenue is $1.00/cwt.

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Beef Margin Watch: December

Beef margins have been generally stronger since the middle of December, finishing 2016 with higher cattle prices while corn costs held steady. Nearby marketing periods against existing placements are positive, while deferred periods against future placements remain negative. Cattle prices have been supported by strong beef demand as well as a relatively tight supply of fed cattle as feed yards have stayed very current in their marketings. USDA's latest monthly Cattle on Feed report showed November placements up 15% from a year ago, while marketings were up 17%. Although November placements were up 241,000 head over last year, combined placements for the two months immediately prior were down 161,000 head from 2015. In fact, the December 1 Cattle on Feed inventory was the lowest on record for that month since 1996, according to the USDA. Meanwhile, Beef Supplies in Cold Storage as of November 30 totaled 531.463 million pounds, down 0.29% from October, but up 4.08% from last year. Feed costs continued to move sideways during the second half of December. On January 12, USDA will release the next WASDE report, which will include quarterly stocks and provide greater insight on domestic disappearance during the first quarter of the crop year. The market will also pay increasing attention to weather developments in South America as we move into the more critical timeframe of January/February. Our beef cattle producer clients continue to focus on current placements against the February and April marketing periods, with adjustments to strengthen existing cattle hedges.

Live Cattle Marketing Periods:

Feb '17 2016 2017 Feb 2017: HIGH **$1.98** LOW **($23.04)** LAST **$0.08** 10YR PERCENTILE **71.8%**

DECEMBER

Apr '17 2016 2017 Apr 2017: HIGH **$8.93** LOW **($39.98)** LAST **$7.70** 10YR PERCENTILE **97.1%**

DECEMBER

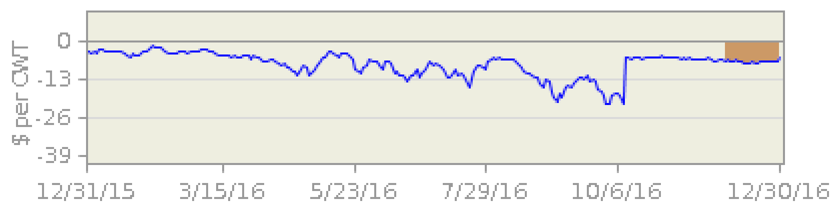
Jun '17 2016 2017 Jun 2017: HIGH **($2.39)** LOW **($33.97)** LAST **($3.01)** 10YR PERCENTILE **84.8%**

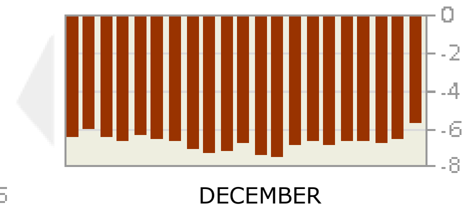
DECEMBER

Aug '17 2016 2017 Aug 2017: HIGH **($2.49)** LOW **($19.19)** LAST **($6.71)** 10YR PERCENTILE **35.1%**

DECEMBER

Oct '17 2016 2017 Oct 2017: HIGH **($1.60)** LOW **($21.47)** LAST **($5.68)** 10YR PERCENTILE **24.9%**





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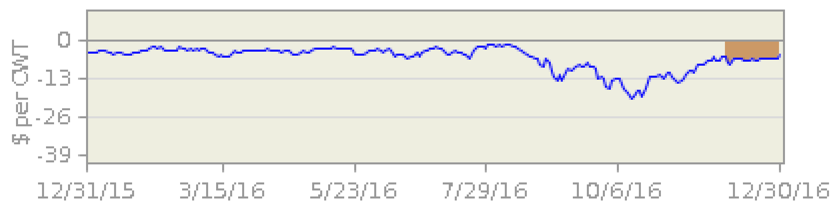
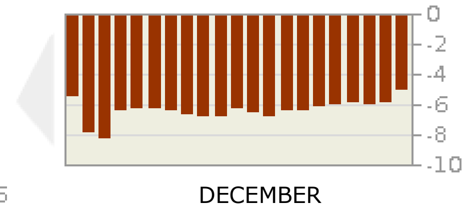
Dec '17 2016 2017 Dec 2017: HIGH **($1.19)** LOW **($20.08)** LAST **($4.99)** 10YR PERCENTILE **25.9%**





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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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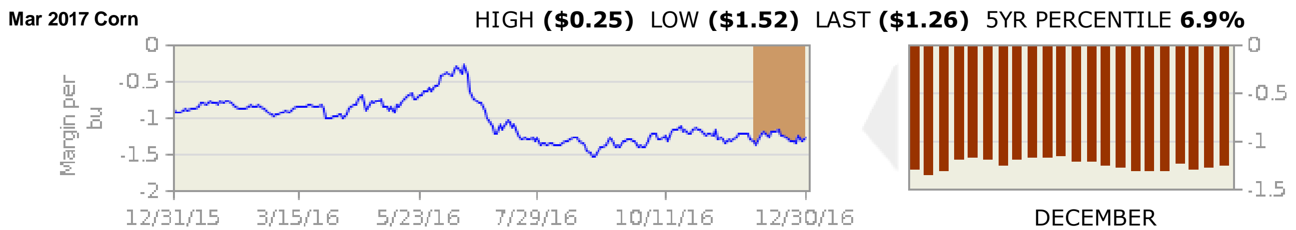
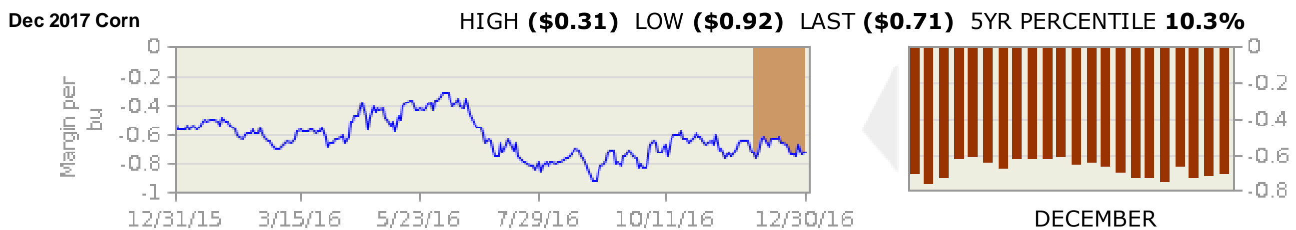
Corn Margin Watch: December

While corn prices and margins were slightly lower the past two weeks, the corn market remains quiet and in a tight range. Looking forward, the January WASDE report will release final harvested acreage, yields and production for the 2016 corn crop, as well as updated demand estimates. Both exports and production of corn based ethanol continue to run at elevated levels. Ethanol production has eclipsed one million barrels per day over the past nine weeks, and sales of corn for export stand at 62.5% of the USDA expectation, almost 7% above the average pace needed to meet the projection. The current USDA export projection exceeds last year's by over 325 million bushels. Some South American weather uncertainties have crept into the fray, in the form of excessive wetness that is impeding planting progress in Argentina, and dryness concerns in parts of Brazil. Our corn producer clients are working on setting targets for next year and continue to monitor South American weather as a potential source of volatility and price movement in the marketplace.



The estimated yield for the 2016 crop is 182 bushels per acre and the non-land operating cost is $595 per acre. Land cost for 2016 is estimated at $238 per acre [1]. Basis for the 2016 crop is estimated at $-0.2 per bushel.



The estimated yield for the 2017 crop is 184 bushels per acre and the estimated operating cost is $547 per acre. Land cost for 2017 is estimated at $228 per acre [1]. Basis for the 2017 crop is estimated at $-0.3 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.

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Soybeans Margin Watch: December

Soybean prices and margins were lower over the last two weeks. The soybean market has been a little more fluid than other grain markets. Weather uncertainties in both Argentina and Brazil are beginning to affect bean prices, as premiums are added then quickly removed following newer forecasts or actual weather events. The recent wetness in Argentina has impeded planting progress and may lead to some crop diminishment, while dryness is cause for concern in parts of Brazil. The final figures of 2016 soybean harvested acreage, yields and production will be released in the much anticipated January WASDE report. Demand categories will also be updated, as exports continue to outpace expectations. Currently 85.6% of the USDA's estimate has been sold, which is 10% above the average pace needed to meet that projection. Meal exports have not been as robust as beans, running just behind the sales pace needed to meet the USDA projection. On the export horizon is a newly announced plan in Argentina to gradually reduce its soybean export taxes. The new tax regime proposed to begin in January of 2018, would shave 0.5% in taxes per month over two years. The result would be a total decrease of 12 points over the two year period, bringing the overall tax down to 18%. There are similar new proposals for Argentinian soybean meal and oil export taxes as well. Our soybean producer clients are working on setting targets for next year, while keeping a watchful eye on weather in South America, where uncertainties remain a concern as we approach the crucial development period.

The estimated yield for the 2016 crop is 52 bushels per acre and the non-land operating cost is $365 per acre. Land cost for 2016 is estimated at $238 per acre [1]. Basis for the 2016 crop is estimated at $-0.3 per bushel.

The estimated yield for the 2017 crop is 53 bushels per acre and the estimated operating cost is $290 per acre. Land cost for 2017 is estimated at $228 per acre [1]. Basis for the 2017 crop is estimated at $-0.3 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.

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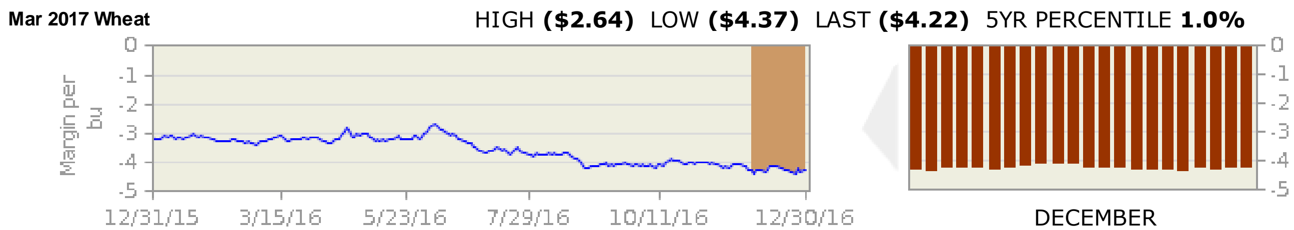
Wheat Margin Watch: December

Wheat prices and margins held steady over the past two weeks, and wheat continues to trade in a very tight range. While world wheat stocks are abundant and stand at record levels, stocks of wheat in India are at ten-year lows. Two years in a row of lackluster production has led to speculation that India will need to import at least six million metric tons this year to relieve local price spikes and spot shortages. India recently suspended its 15% import tax on wheat, in spite of growers' concerns about cheaper imports flooding the market. U.S. wheat exports sales at 78% of the current USDA expectation are just ahead of the average pace needed to meet the projection. The U.S. winter wheat crop needs snow or rain to replenish depleted soil moisture levels that were never recharged after a dry start this fall. Our wheat producer clients are working targets for next year's crop, and stand ready to capitalize on any favorable movement in the wheat market.



The estimated yield for the 2016 crop is 67 bushels per acre and the non-land operating cost is $358 per acre. Land cost for 2016 is estimated at $158 per acre [1]. Basis for the 2016 crop is estimated at $-0.6 per bushel.

The estimated yield for the 2017 crop is 68 bushels per acre and the estimated operating cost is $358 per acre. Land cost for 2017 is estimated at $150 per acre [1]. Basis for the 2017 crop is estimated at $-0.3 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.

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