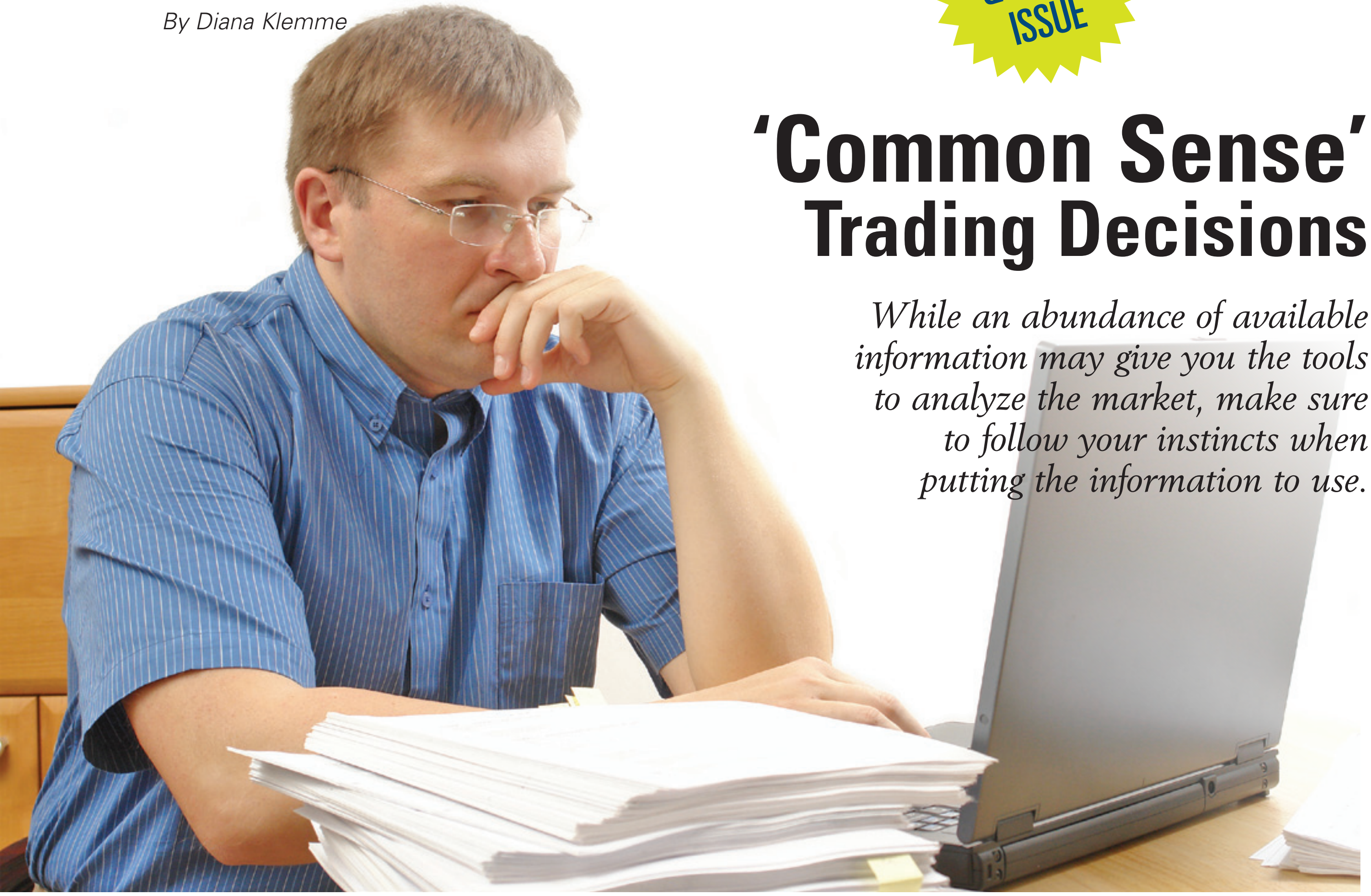
MERCHANDISERS' CORNER

GRAIN QUALITY ISSUE

By Diana Klemme

'Common Sense' Trading Decisions

While an abundance of available information may give you the tools to analyze the market, make sure to follow your instincts when putting the information to use.



"Everybody gets so much information all day long that they lose their common sense."

— Gertrude Stein, author

Information overload plagues most of us these days. Blackberries and cell phones feed us text messages whether we want them or not. Global news is available instantly to anyone with an Internet connection. Powerful, cheap computers let anyone develop in-depth analyses and graphics from online databases. (Psst… Want to know the trendline growth of China's hog population? Check USDA's website.)

Modern technology is terrific. I use it daily, spend a lot of time at USDA's databases and have constructed more charts and PowerPoints than I can count. But sometimes we have to stop gathering and analyzing and use a little common sense ("CS") when making grain merchandising and pricing decisions. What goes up *can* go down; what *can't* change — *may* change. Two areas come to mind where some CS may serve us well right now:

- Grain quality
- Futures spreads

Corn and wheat quality continue to plague many areas of the country. A significant amount of remaining 2009 western hard red wheat is low protein and has apparently been tucked away to blend with new-crop. A lot of '09 soft red wheat stocks contains vomitoxin, reducing the value and limiting the potential markets. The 2009 corn crop in many areas suffers from low test weight, mycotoxins, high moisture, or worse. Quality problems have forced merchandisers and managers to confront tough choices.

Wide futures carries will pay the costs of holding poor-quality grain into the 2010 crop year to capture blending opportunities and/or the potential for reduced discounts, and higher overall revenue. Some merchandisers have focused heavily on futures spreads, setting objectives to capture as high a carry as possible.

Kansas City wheat futures carries have been trading recently at

Diana Klemme is a longtime contributor to *FEED & GRAIN*. Contact her at Grain Service Corporation, Atlanta, GA, by calling (800) 845-7103 or e-mail at diana@grainservice.com.

90% to 97% of "full carry," the theoretical maximum monthly futures carry (excl fees/commissions). Merchandisers see that KC wheat has been paying almost 6¢/bushel carry per month, well above a country elevator's interest cost (around 2¢/month). That extra 4¢ is a nice monthly return for space. Add in any potential for blending better new-crop wheat with lesser-quality old wheat and filling elevators with company-owned hard-red wheat looks like a great deal. It may well be, but there's a lot of wheat out there and spring/summer basis has fallen to extremely weak levels. Buyers aren't sure what the quality of ´10 wheat will be and can't sell/export low-quality wheat. This has left a number of elevators long the basis with declining nearby basis values and no profitable way to liquidate.

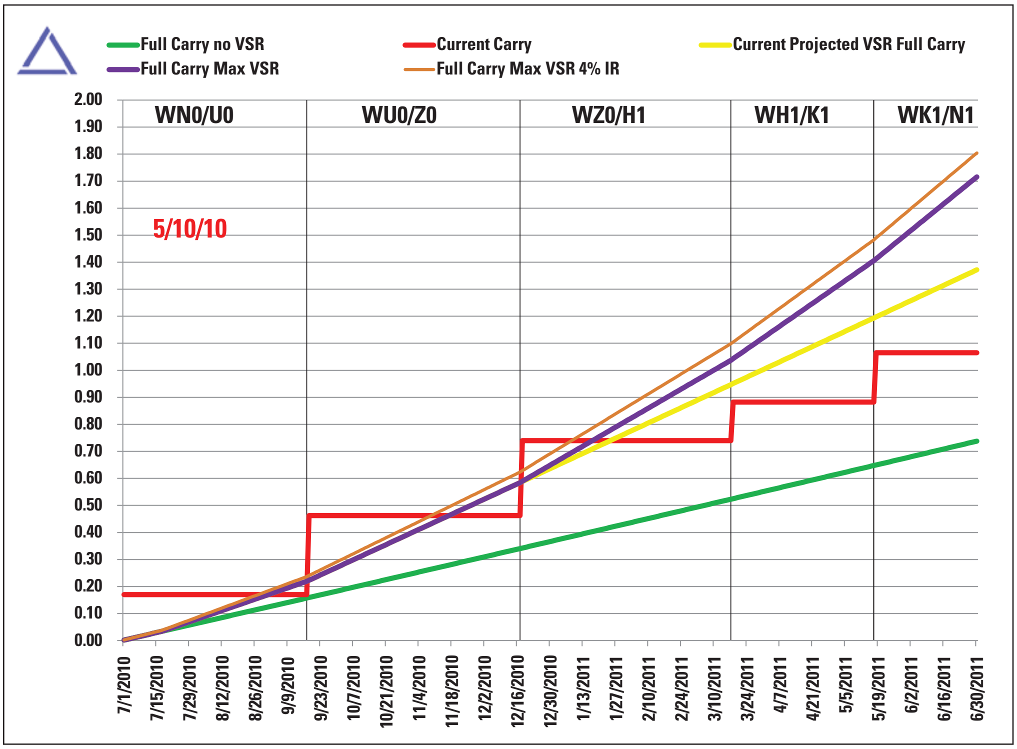
Wide futures carries will pay the costs of holding poor-quality grain into the 2010 crop year to capture blending opportunities and/or the potential for reduced discounts, and higher overall revenue.

The new CME Variable Storage Rate program on soft red wheat provides a way that wheat monthly futures storage charges can change with each delivery cycle, depending on certain market parameters. (*See October 2009 issue, "Wheat, The Road to Convergence."*) With a surplus of wheat here and abroad, the futures market has anticipated that the VSR will expand to its maximum storage rate and spreads are already pricing in a lot of that potential. July 2010/July 2011 CBT wheat is trading around $1.05 carry (8 3/4¢/month), far above the old "full carry" of about 73¢, but still below the *new* theoretical maximum VSR carry of about $1.73/bushel. That $1.73 for 12 months would pay 14.4¢/month to an elevator! Little wonder country elevators are raising their basis for summer 2010; they want to own wheat and earn storage revenue to hold wheat that exporters and mills don't want! The projection is made easier with spread charts and analyses that can quickly map out just what each spread is paying. (*See chart.*)

Corn has a similar story. A lot of corn won't make export quality, and in some cases isn't good enough for feed operations. Elevators look at current basis values, values for deferred slots, and at the futures carries. They see cash carries of 30¢ or more for six months down the road in some markets, well after 2010 crop corn has been harvested. Most of that carry comes from the futures spread, July10/December10 CBT corn futures show about 29-30¢ carry. Imagine, merchandisers can sell basis for harvest or perhaps January 2011, earn 30¢ or more, *and* blend lower quality old-corn with new-crop. That's a lot of potential revenue.

Wide futures carries are indeed sending signals to warehousemen to buy and hold wheat and corn, with the added prospect of raising quality by blending with better quality new-crop stocks.

Other merchandisers have focused on what *volume* of "good" corn or wheat it will take to blend off their bad stocks. Some have been aggressive, bidding



above competition for new-crop to ensure sufficient inventory for blending later. Spreadsheets can help calculate just what quantities they need.

Charts and spreadsheets show that owning hedged wheat is the logical use of space, and owning hedged corn should at least turn out OK (if there are blending gains to be earned). Market letters and comments these days talk about the global surplus of wheat and how the United States is becoming the residual warehouse to the world, paid to carry unwanted wheat. Everyone's bombarded with market signals. This is where "CS" needs to weigh in.

Don't count your chickens

Going into harvest with large quantities of off-grade wheat or corn may turn out much different than expected if problems arise with the 2010 crop. That could leave elevators dealing with *two* problem crops instead of one. And remote as it may seem, there *is* always the risk that the futures carries could vanish. Then all those carefully projected returns could vanish.

The "CS" decision may still be to carry old-crop grain into new-crop. But CS may tell you to quit counting chickens before they're hatched. The big and unanswered question in the decision is the cost if the futures carries vanish. What if there is an unexpected wheat crop failure in the former Soviet Union, or Australia? Turning down $1.05 for a 12-month Chicago wheat carry, betting on something closer to $1.70, or turning down 95% of full carry in KC, could suddenly turn into a very costly mistake. As impossible as it may sound, corn spreads could also narrow quickly if the U.S. 2010 crop turns out short, or if China buys enough U.S. corn to sharply reduce ending stocks in 2011.

CS says to lock in excellent futures carries if you plan to hold the hedged inventory, or at least protect the carry on *most* of the inventory. Use charts and spreadsheets to analyze the numbers, and listen to the market recommendations, but use common sense to add perspective and to frame your decisions. ■

"Yeah, but your scientists were so preoccupied with whether or not they could, they didn't stop to think if they should."

— Jeff Goldblum as Dr. Ian Malcolm, Jurassic Park, 1993