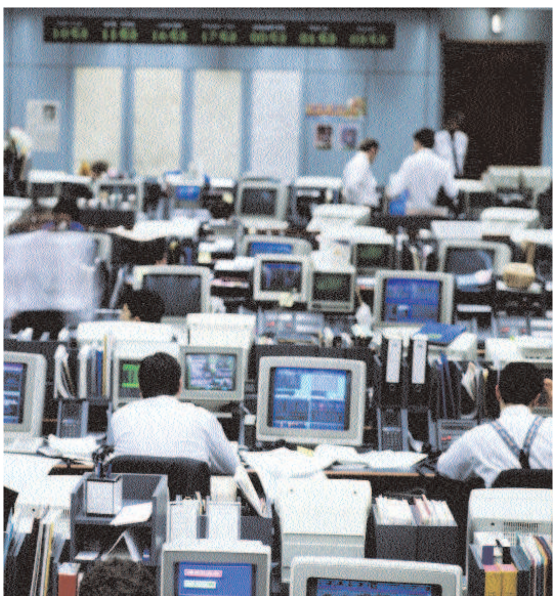
By Diana Klemme

Learn from the Past, Trade in the Present

Thought merchandising 2002 crop was a challenge? Watch out for 2003!

Mike swivels in his chair, looking out the window on a bright November morning at the train loading soybeans for Mexico. "It's been a good market, for sure," he thinks to himself, "but I need to focus on this year's truck merchandising program."

He rolls to the computer screen, checks some futures quote and listens to the group of farmers debating outside his office. He sighs to himself, "Enough already, Mike — get to work!" He leafs through papers on his desk until he finds his 2002 crop soybean basis chart.



He scans the charts. "Wow — merchandising soybeans was rough last year. I'm sure glad it's over. Seldom saw much carry in futures, usually had to deal with an inverse, and basis chopped around more than usual. But was it really that unusual?" Mike pauses and, reaching for his coffee cup, fumbles through papers on his desk. "I know I have those 2001 crop charts around here, too — let's look at those."

He finds the older charts and scans them. "Well I'll be darned; soybean basis was even choppier in '01 than in '02 crop, and we didn't always have a futures carry in 2001 crop either! And we had a record soybean crop and a 50 million bushel bigger carryout! I better rethink my ideas for this year."

Mike scans his 2002 crop corn basis chart and shakes his head. "Well, there sure wasn't much carry in futures last year when we got to first-notice day each cycle, but my costs were low and the basis moved around enough to let a good trader make some money! Just wish I'd done a better job on spreads, though. But overall I think I did better than I'd projected last fall."

Pulling out his 2001 crop corn basis chart, Mike shrugs: "Man, now that was a very good year — just like a fine wine. Wide futures carries, basis that climbed steadily and slowly from harvest to April — what more could I want? Hmm, a repeat this year would be good, but I doubt that'll happen. This looks more like last year than

2003 crop: Market & merchandising factors

CORN

- Corn crop = 9.85 billion bushels
- Expected carryout in 2004 = about 990 million to 1 billion bushels; tight, but not like 1996
- Futures: higher than last winter/spring? Better odds for at least a short-lived bull market
- Need to keep prices high enough to ensure acres for 2004! Helps farm selling?
- World ending stocks down sharply! Impact??
- How much corn are farmers putting under loan vs. taking LDP (if any)?
- Export sales pace: ahead of 2002/03, China expected to export less
- Increased corn use for ethanol

SOYBEANS

- Soybean crop: 2.7 billion bushels
- Expected carryout in 2004 = extremely tight, under 100MM?
- Wild basis next summer due to tight stocks. Impact on futures spreads?
- South American 2003 soybean crop: up sharply from 2002 crop. Impact??
- China may import less than last year, but is still a major factor. Good for U.S. exports.
- Need to buy U.S. acres for 2004! Rallies encourage selling??
- Soybean loan entries vs. LDP activity (if any).

- CBOT Illinois Waterway Delivery System (IWDS): delivery basis for cash corn and soybeans? Impact on spreads will vary.
- Interest rates: should stay low
- Higher fuel/energy costs this year. Impact? Higher freight?

CORN	
Strong basis	**Weak basis**
■ Increased corn demand for ethanol, livestock feeding is rising again	■ Futures higher than last year; farmers might be more willing sellers this year . . .
■ Higher projected export demand	■ Seasonal movement for year-end taxes
■ Harvest is over; farm selling is lessening	■ Buyers showing little interest in spring or summer coverage
■ Wider futures carries encourage holding when costs are low	■ Commercial ownership of inventory seems higher than last year
■ Late summer strength as supplies dwindle or buyers get anxious	■ Need to pick up ground piles, core bins, etc.

two years ago."

After scanning some e-mails and checking a few websites, Mike reaches for a legal pad. He jots down some things he thinks might or will affect basis and spreads. He puts question marks by some that may be important but it's unclear what impact they might have for merchandising.

Mike rocks back and looks over the list. "Not a bad start, but now I need to focus on what the factors may do to basis." He starts a new sheet for corn.

Mike stops to review the CBOT delivery system on corn and soybeans. He recalls this became important in the summer of 2003 and moved spreads a lot. He pulls out a folder and looks at notes he saved about the delivery process.

1. A firm registered for delivery of corn and soybeans can issue delivery shipping certificates without having the grain in-store.

2. Each delivery location on the Illinois River is assigned a fixed premium based roughly on barge freight differentials. For example, delivering corn or soybeans at LaSalle, IL earns a 2.5¢/bushel premium on delivery.

3. #1 yellow soybeans earn a fixed 6¢/bushel quality premium.

4. #2 yellow corn is standard, no premium. #1 yellow corn earns 1.5¢ premium.

5. If a long (buyer) issues loading orders against a corn or soybean delivery, the seller (river house) earns a 4¢ "load-out" fee.

By Mike's calculations, that means an Upper Illinois River location that delivers soybeans against a futures sale is able to earn the equivalent of about 12¢ over futures. (-0- futures + est 2.5¢ freight premium + 6¢ for #1s + 4¢ load-out). Delivering on a corn futures sale earns a basis value of about +6 ? (-0- futures + 4 load-out + 2.5 freight premium).

Mike recalls that when Gulf basis weakened below these equivalent values in 2003, spreads widened as the trade expected to see deliveries. Then when basis climbed a little higher than delivery value — but before the beginning of the futures month — spreads tightened as the chance of deliveries lessened.

By now it's lunchtime and Mike heads to town, figuring a good pork tenderloin sandwich will clear his thinking.

Later, back at his desk and recharged, Mike has firmed up some ideas for his merchandising plans. "First off, I know this is just a preliminary step — I don't want to get locked into anything too specific this early. But this year is shaping up a lot like 2002 crop. I'll start with this:

- *Watch delivery values against cash barge values.*
- *Be patient. Tight corn stocks in 2004 should make it hard for buyers to consistently and easily cover needs. Basis volatility is good for me and futures carries buy me time!*
- *Plan to hold a sizable long corn basis position.*
- *When corn spreads will pay 3¢ or more per bushel per month, I'll roll short hedges forward. Waiting for that "extra" got costly last year as decent carries often disappeared by first-notice day.*
- *Always sell at least some corn forward for each delivery period so I don't have to rely on spot basis values.*
- *I bet the soybean basis will have as much negotiating room at processor markets as it did last year. I'll minimize "back to back" trading and work more on my "horse-trading" skills.*
- *I want to get out of my long soybean basis position before January and begin to get short basis via shorting Delayed Price. Holding ownership usually loses money if futures invert again.*
- *I want to originate on-farm grain with flexibility to swing to local processors or come into the elevator for train loading. Too soon to say if export or domestic will be best.*

Mike looks over his notes and decides this gives him some direction for the next few months.

"Got to remind myself not to get greedy on spreads, and to be a tougher negotiator on basis, though. I know I left money on the table last year. ■

Disclaimer: This story's basis charts use published bids each Thursday from an actual Midwestern processor market. Each horizontal line represents 1¢ basis. Each heavy horizontal line represents a zero basis against the spot futures month. For example, on September 26, 2002 the soybean basis was -0- November, and approximately -16 November on October 3. Futures spreads for these charts are as of each sequential first notice day (November/ January spread on October 31). Crop production numbers are approximate as of September 2003. All information in this story is not guaranteed as to its accuracy or completeness. Hypothetical results have certain limitations and do not represent actual trading. Past results are no guarantee of future results. Trading futures involves risk of loss.