

Master Marketer Newsletter

<http://mastermarketer.tamu.edu>

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Master Marketer Highlights

Beef Cattle Short Course

The 58th Annual Beef Cattle Short Course conducted by the Texas AgriLife Extension Service is set for August 6-8 on the campus of Texas A&M University in College Station. A variety of cattle production management topics including forage management, beef cattle marketing, weather outlook and the long-term cattle market outlook are to be included in the presentations. The general session will focus on what consumers want to know about raising beef and will feature a virtual tour of a U.S. feedyard and beef packing plant. Participants will be able to choose workshops based on their level of production experience and needs of their ranch and have access to on-site demonstrations including brush-busting, penning, and chute-side calf working. In providing cutting-edge information, there will also be an industry trade show featuring over 100 agricultural businesses and service exhibits.

Registration is \$160 per person and includes educational materials, entrance to the trade show, and proceedings from the Beef Cattle Short Course, along with a prime rib dinner, lunches, breakfasts, and daily refreshments. A tentative schedule, registration, and more information can be found online at <http://beef.tamu.edu> or by calling the office of Dr. Jason Cleere at (979) 845-6931.

Ranch Estate Planning

In conjunction with the Beef Cattle Short Course, Dr. Wayne A. Hayenga will be conducting his Ranch Estate Planning Seminar August 8-9 at the College Station Conference Center, 1300 George Bush Drive, in College Station. The seminar is designed to provide participants with information on tax and estate planning matters in making estate planning decisions. Dr. Hayenga will be presenting an analysis of income and estate tax rules as they affect families and agricultural businesses and will be discussing estate administration and tax reporting requirements for the surviving spouse.

Dr. Hayenga is a Professor Emeritus and Extension Specialist with Texas AgriLife Extension. As an agricultural economist and attorney, he is an excellent communicator working with farmers, ranchers, and family-owned firms in the financial, business, and estate tax planning realms. His experiences as a farmer, banker, and lawyer provide illustrated examples of estate and income tax law provisions with an entertaining style. Enrollment is limited and there is a registration fee of \$150 per person that includes refreshments, all seminar materials, and a lunch. More information can be found at agecon2.tamu.edu/people/faculty/hayenga-wayne/BrochureREP.pdf or by contacting Connie Smotek at csmotek@tamu.edu or (979) 845-2226.

Standardized Performance Analysis (SPA) for Sheep Operations

The Standardized Performance Analysis may be recognized in the world of beef cattle but renewed efforts are being made to include sheep operations. SPA is a tool used to establish baselines and analyze ewe-lamb operations. For this to be a successful effort, sheep producers are encouraged to participate for an overview of their performance as well as a regional comparison of their operation's strengths and weaknesses. Information provided from operations is used to determine specific expenses associated with costs of production and return on assets. The available statistics in the program's database remain anonymous and aid in developing regional production and financial benchmarks.

Participation in the SPA program is done on an individual basis. After an owner states their objectives and wants in their operation, SPA identifies certain areas needing change to ensure those objectives are met (ex: Where is my ranch going and how is it getting there?). The program facilitates the comparison of an operation's performance between years, groups of producers, production regions, and production systems. For more information in participating in the SPA program, please contact Bill Thompson at w-thompson@tamu.edu or (325) 653-4576.

Rebuilding the Beef Herd

Planning...to capture opportunities. The Texas AgriLife Extension Service continues its Rebuilding the Beef Herd educational workshop series, part of a statewide educational initiative, on July 26 at the Lampasas County Farm Bureau office, 1793 North U.S. Highway 281, in Lampasas. Although Texas producers are in a much different environment than what they had grown accustomed in the cattle world, there seems to be an urgent matter amongst cattle producers in moving forward. The workshop will be presenting information on challenges in agriculture financing, forage recovery, options for replacements, value of replacements, and generational turnover, while also offering pesticide applicator CEUs to license holders.

Registration is \$40 per person and includes lunch. For more information and registration, visit <http://animalscience.tamu.edu/academics/beef/rebuilding/> or call the AgriLife Extension Service Office in Lampasas County at (512) 556-8271. Overall, this program is intended to serve as a planning and decision tool for cattle producers seeking to rebuild herds.

Food and Fiber Economics: What to Expect from Expanded Trading Hours?

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The Intercontinental Exchange (ICE), most noted as a commodity exchange for energy, financial, and agricultural “soft” commodity futures, has begun trading grain and oilseed contracts in competition with the CME Group’s Chicago Board of Trade. One distinctive feature of trading grain contracts on the ICE is a 22-hour trading window. Grain contracts in Chicago currently trade from 6:00 pm to 7:15 am and then 9:30 am to 1:15 pm Central time. The ICE grain and oilseed contracts trade from 8:00 pm to 6:00 pm Eastern time the next day. In response, CME announced it would expand to a 22-hour trading day as well, but has since pared that back to 21-hours, 5:00 pm to 2:00 pm Central time.

What will the expansion of trading hours mean to the agricultural producer looking to manage price risk using futures and options? Aside from an extended opportunity to enter and exit the markets, the expansion of trading hours means that the markets will be open at 7:30 am when USDA releases many of its market moving reports like World Agricultural Supply and Demand Estimates (WASDE), Grain Stocks, Planting Intentions, Acreage, and others. To answer the question of what the impact expanded trading hours will have on the hedging activities of farmers and ranchers, we need to consider how expanded hours relate to the overall purpose for which futures markets exist as well as consider the structure of the modern commodity futures exchange. Both are important in gauging the impact of this trading rule change and how the commodity trading business may continue to evolve.

The Purpose of Futures Markets The traditional answers to the question of “What is the purpose of futures markets?” are price discovery and market liquidity. That is, the buying and selling of futures contracts allows for an efficient discovery of the price of a particular commodity, made publicly available, given the best information held by market participants. Liquidity refers to the numbers of market participants such that at any point in time there is a buyer for a willing seller, and vice versa, and that no one participant is large enough in proportion to the trade such that he or she can influence the price. In that regard, round-the-clock trading may be beneficial to both objectives; more participants trading on 24-hour information thereby enhancing both price discovery and liquidity.

The more practical answer to the question “What is the purpose of futures markets?” is “To make money.” The major commodity exchanges, like CME Group and ICE, are for-profit businesses with much of that profit generated by the volume of trades. Virtual, round the clock trading will likely generate little additional volume from commodity producers and users. But, given the global nature and worldwide interest in commodity markets today, the change is directed at the institutional investor particularly seeking to attract overseas market participants. Expanded trading is also designed to try to gain market share from other competing exchanges.

Trading Issues Even though the Chicago Board of Trade still has open outcry pit trading, the vast majority of contracts in grains and oilseeds are traded electronically; ICE futures trading is exclusively electronic. Many of these electronic trades are executed by computer generated trading systems. The concern is that allowing trading to take place at the time a market sensitive USDA report is released would increase volatility, as traders would be motivated to quickly place orders without the time they currently have to pour over the numbers and more reflectively weigh the price implications of the report. Furthermore, the rise of high-frequency trading powered by computer algorithms may contribute to excess volatility if the computer programs begin to react to the price changes caused by the reports. If the algorithmic trading is not closely supervised by humans during such periods, the extended trading hours may lead to an increase in flash crashes like the one observed in S&P 500 ETF trading in May of 2010. One way that the traders may adapt to this situation is an increase in pre-report positioning, although this still may not prevent unanticipated surprises and sharp market reactions.

An important safeguard for hedgers and speculators, alike, is still in place as trading hours are expanded — the daily trading limit. For corn, the most the closing price can vary from the previous day’s close is 40 cents on both the ICE and CBOT. When the market hits the daily price limit, trading is suspended or “locked” until the next day. These limits are expandable on succeeding trading days under certain conditions, but do offer an important cool-down period in the case of extreme volatility. In 2011, the Chicago December 2011 corn futures contract traded at the exchange imposed limit nine times, with four limit up moves and five limit down moves. Three of these locked limit days coincided with USDA reports: March 31 Planting Intentions and Grain Stocks, June 30 Acreage, and the September 30 Grain Stocks. It is interesting that only three of the nine limit days in 2011 coincided with USDA report releases. One of the criticisms of expanded trading hours has been that the markets would be open when the reports are released.

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Choice Website

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Weekly Texas Hay Report

http://www.ams.usda.gov/mnreports/am_gr310.txt

The USDA Agricultural Marketing Service (AMS) releases a weekly hay report for several states in the U.S. The Texas weekly hay report is released on Fridays and contains a narrative explaining the current week's hay situation (prices, production, etc.) as it compares to the previous week's numbers. In addition to the short narrative, the weekly report covers prices and descriptions for various types of hay (alfalfa, coastal Bermuda, wheat hay, and wheat straw) and qualities (supreme, premium, good, fair, and utility) for different regions within the state.

Previous reports are housed at <http://search.ams.usda.gov/mnsearch/mnsearch.aspx> and can be retrieved by using the "AM_GR310" title in the search feature. These reports provide producers references in comparing prices, quality, and quantity by location from one season to the next. Additional resources for pricing information are located within the report as well.

Farm Assistance Update

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Unprecedented Change. That was the title of this update several years ago. Looking through past comments it is amazing how often we mention change: changing commodity markets, changing production costs, changing farm policy, changing climate, changing diapers. OK, we rarely discuss the last one in this spot, but it too requires your constant attention. And that is exactly the point. In any business and in particular agriculture, the world around you is ever changing. If your strategies and plans are not also changing, you will soon find yourself playing catch up and/or under a large pile of... diapers.

Strategic financial planning is an ongoing exercise. Many of our clients update their analysis each year, constantly evaluating their financial situation and outlook. If it has been a while since you conducted an analysis with us, there is no doubt much has changed in and around your operation. No one knows exactly what the future holds, but now is always a good time to evaluate and re-evaluate the financial outlook for your operation and prepare for the possibilities. Contact FARM Assistance toll free at (877) TAMRISK or online at: farmassistance.tamu.edu

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More often than not, other market events were sources of limit moves. Traders have to be adept at responding to market news whenever it occurs and would likely adapt quickly to USDA reports being released during trading hours. This has, apparently, been the case over the last five years when cotton futures were trading during the release of major USDA reports. Real time trader responses are also evident in livestock markets where some of the major futures markets moves have come from other events like BSE discoveries.

Another concern, moving forward, is that exchanges seeking increased trading activity may not want markets locked down under price limit restrictions. The incentive to appease the institutional investor may be to either increase limits, or change the amount of time before the limits reset, or perhaps both. For instance, instead of waiting until the next trading day, will a period of a few hours be seen as sufficient for markets to cool down and trading to resume?¹

It can be argued that the functionality of a commodity futures exchange may benefit from a longer trading day through enhanced price discovery and liquidity, but there are costs as well. If the new trading structure results in increased volatility, then that means the financial risk and cost of holding a futures position (maintaining a margin account) will increase. This cost will be borne less by the high frequency traders who are in and out of the market quickly and more by the hedger or commercial trader whose aim is to lock in a price and reduce price risk. That does not mean that futures markets will cease to be a viable tool for managing price risk, but producers and users need to consider how changing trading rules impact their hedged position.

Why not trade 24 hours instead of 22? The simple answer is that there has to be a time to "settle up" the day's trades. On paper, each trader's account is balanced at the end of each day using the settlement prices of that day. This accounting determines whether or not a trader receives a margin call. Margins assure financial performance of futures trading, guaranteeing that both buyers and sellers ultimately meet their financial obligations. The daily settlement time allows margin accounts to be adjusted to account for the impact of the day's trading activity. At the end of the month it allows final settlement on an expiring contract.

¹ A third variable is that options markets still trade when futures are locked in a limit move. Options markets may "heat up" while futures markets are "cooling down." This has implications for options traders and holders of futures positions as well. When this happened in cotton in March of 2008, option premiums were used to synthetically derive futures values that were then used as settlement prices for margin accounts. The resultant margin calls were far in excess of what would have been required if the last actually traded futures price had been used.



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If you would like to receive this newsletter by email or mail,
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An archive of newsletters can be found online by visiting
<http://agecoext.tamu.edu/programs/marketing/master-marketer-program/newsletter-archives.html>

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