

# Texas A&M Master Marketer

## October 29, 2020

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# Tying is All Together

# What Have You Learned?

- \* **Mechanics of Hedge**
- \* **“Tools of the Trade”**
- \* **Working with Options**
  - \* **Puts and Calls**
- \* **Basis**
- \* **Fundamental Analysis**
- \* **Technical Analysis**

# *So What is the Problem*

- \* What is your attitude towards risk management?
- \* Are you a producer looking to reduce price risk?
- \* Are you a “trader”?
  - \* A mix between risk manager and trader?
    - \* What exactly does that mean?

# What “Drives” Your Decision Making?

- \* Logic?
    - \* What does that mean?
  - \* Greed and Fear?
    - \* What does that mean?
  - \* Cash Flow/Money?
    - \* What does that mean?
- 
- \* Are you a “trader”?

# Are you a Trader?

- \* **What makes a good trader?**
- \* *Cemeteries are filled with people that died “broke” and they were right, but too early.*
- \* **Liquidity**
  - \* “The market will stay irrational much longer than you can stay liquid.”
  - \* Trade the volumes that keep you liquid.
- \* **Patience**
  - \* “Buy Price Breaks and Sell Price Rallies”

# What makes a good trader?

- \* **Extracting as much emotion out of the decision making process as possible**
  - \* **Panic Selling and Panic Buying**
- \* **Understanding how all of the marketing tools work and how using different combinations can reduce trade risk (usually at the expense of reduced profit opportunity).**

# Can you implement these ideas into price risk management plan for your operation?

- \* **Absolutely!!**
- \* In general, many of the aspects of “good trading” can be applied to making good risk management.



# Can you implement these ideas into price risk management plan for your operation?

- \* The difference being that “Price Risk Management” is much easier.
- \* Why?
- \* BECAUSE YOU HAVE THE PHYSICAL PRODUCT TO SELL OR BUY!!!!

Ask yourself a very serious question?  
Where are you in this process?

- \* Categories of Agricultural Risk Managers
  - \* Curious Scratcher
  - \* Traders disguised as Risk Managers
  - \* Disciplinarians
  - \* Opportunist

# Ask yourself a very serious question? Where are you in this process?

## \* Curious Scratcher

- \* Really just interested in learning about how the markets work.
- \* Will not seriously try to do much different.
- \* Will likely help them in some market decisions because they will understand the markets a little better.
- \* But will more likely lead to more “head scratching” and thoughts of “I should have done this or that”.

# Ask yourself a very serious question? Where are you in this process?

- \* Traders disguised as Risk Managers
  - \* This category evaluates your risk management by whether or not your futures account makes money on a year by year basis.
  - \* Example:
    - \* You sold 20,000 bus of Dec corn at 4.00. You produce 200,000 and it was sold at the equivalent of 3.20 December corn. But you are very happy because your futures account shows a \$16,000 profit for the year.
  - \* This group cannot stand margin calls and in and out at many times during the year. Does not see rally as opportunities.
  - \* Just as likely to be long as short.
  - \* Very likely to buy rallies and sell price breaks.
  - \* Example: Sells 20,000 bus Dec corn at 3.60. Market rallies to 4.20 and they sell 200,000 bus corn at an equivalent of 4.20. And they are unhappy because they lost \$12,000 in the futures market.

# Ask yourself a very serious question? Where are you in this process?

## \* Disciplinarian

- \* Clearly understands how futures, options and forward contracts work.
- \* Uses discipline in marketing decisions. driven by profit margin, cash flow and risk.
- \* Many times uses price risk tools to reduce price risk even when they think prices will go higher than the current level.
- \* Could care less whether or not there is a profit in futures account at the end of the year.
- \* Does understand at times there are prices that they feel does not warrant having price protection.
- \* Sees higher prices and margin calls as opportunities.

# Ask yourself a very serious question? Where are you in this process?

## \* Opportunist

- \* Different from the disciplinarian in that not really making decisions off of margins, cash flow and risk, but rather on big moves in a market that are seen as opportunity.
- \* Believes this because there is belief that markets eventually move to a “norm”. Because of economics.
- \* So if they are believed to already be in a norm, then it is not view as an opportunity.

# Ask yourself a very serious question? Where are you in this process?

- \* Is it possible to “flip flop around” and/or evolve to another category?
  - \* Absolutely.
  - \* But knowing who you really are and what your are trying to accomplish is the most important step to being successful.
  - \* Failure to do that usually results in failure or perceived failure.
  - \* Understanding where you are will also help you decide which tools to use:
    - \* Forward contracts
    - \* Futures
    - \* Options.

# What is your Marketing Attitude?

- \* Blaming someone else will not cut it!
  - \* Have government programs made US grain producers less successful price risk managers?
    - \* Yes
- \* Does your marketing plan include dreams of “grand slam home runs”?
  - \* Or are you happy with singles that turn into doubles?



# What is your Marketing Attitude?

- \* How much price protection do you need?
  - \* What is your risk profile?
    - \* Financially
    - \* Mentally
- \* When do you need price protection?
  - \* Certain times may represent more price risk?
    - \* For example to increase the size of your operation
      - \* Feed more cattle?
      - \* Take on more acres?

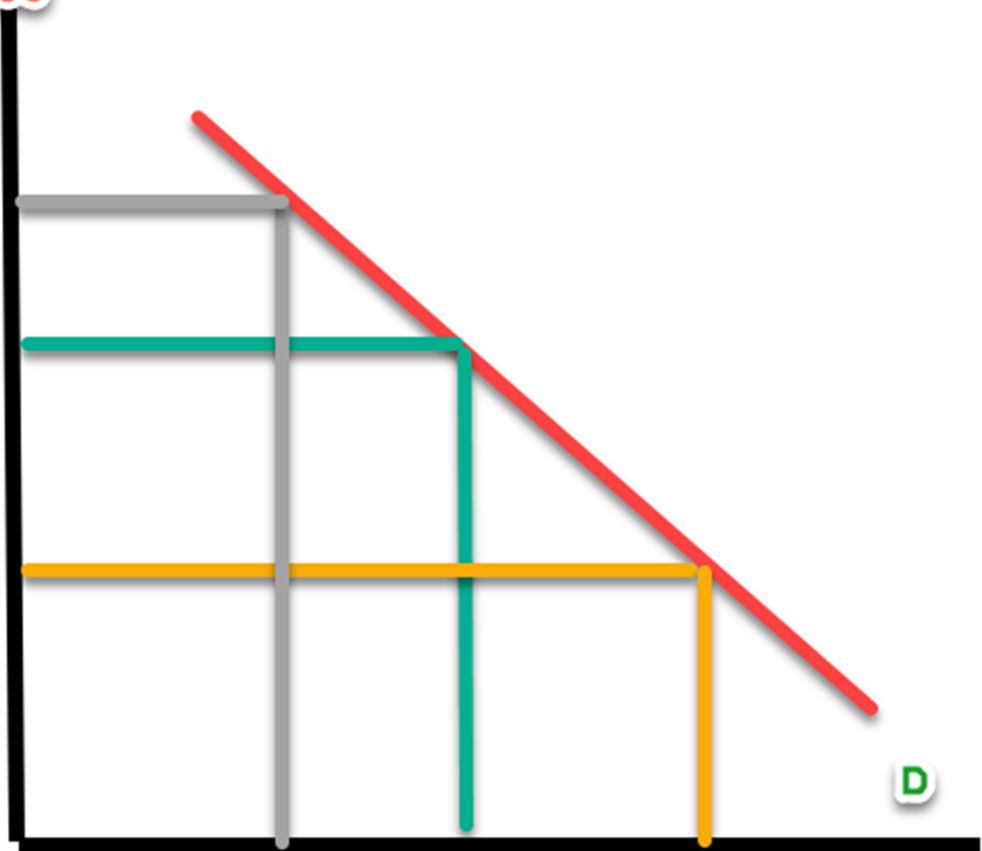
# What is your Marketing Attitude?

- \* At what price levels do you need price protection?
  - \* Are there certain price levels that make you want to have price protection?
  - \* Other price levels make you want to remove or not obtain price protection?
    - \* How do you do that?
    - \* Does that make sense?

# Understanding Economics (101)

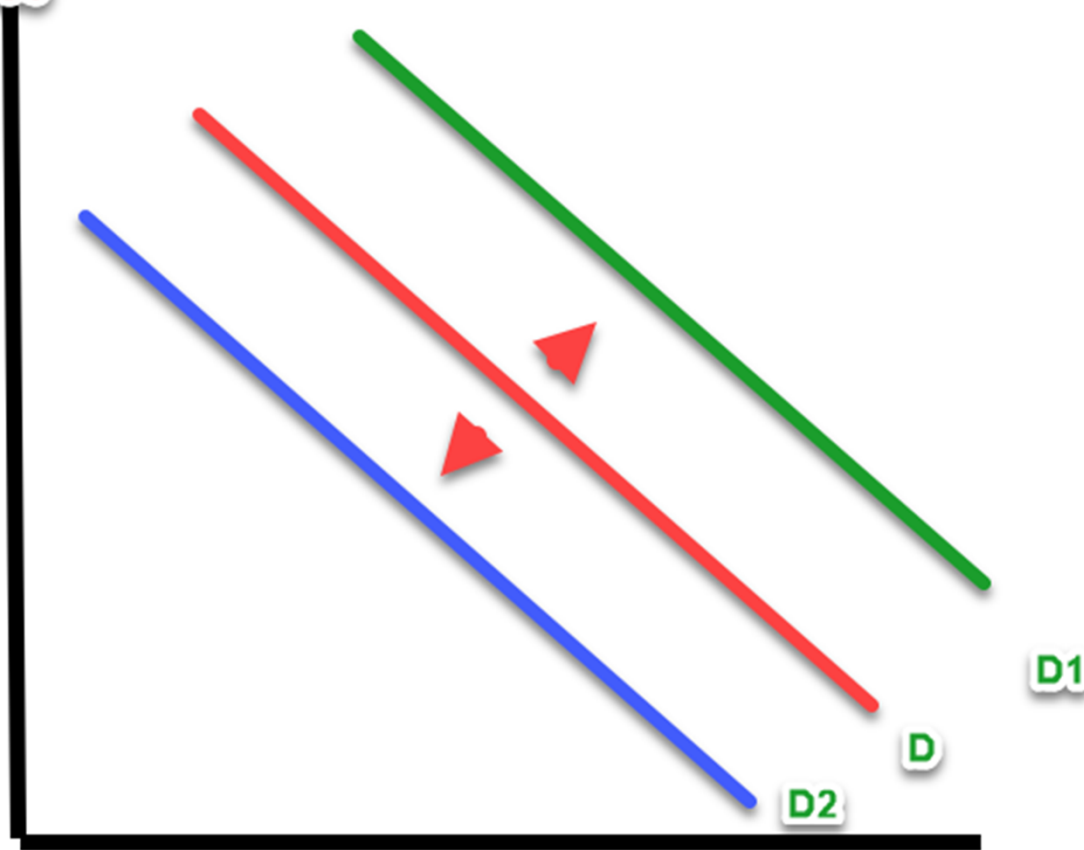
- \* How do markets really work?
- \* Why does a market move up and down?
  - \* Money Flow!!
- \* What is supply and demand?
  - \* We use these terms too loosely and with the wrong definition.

Price



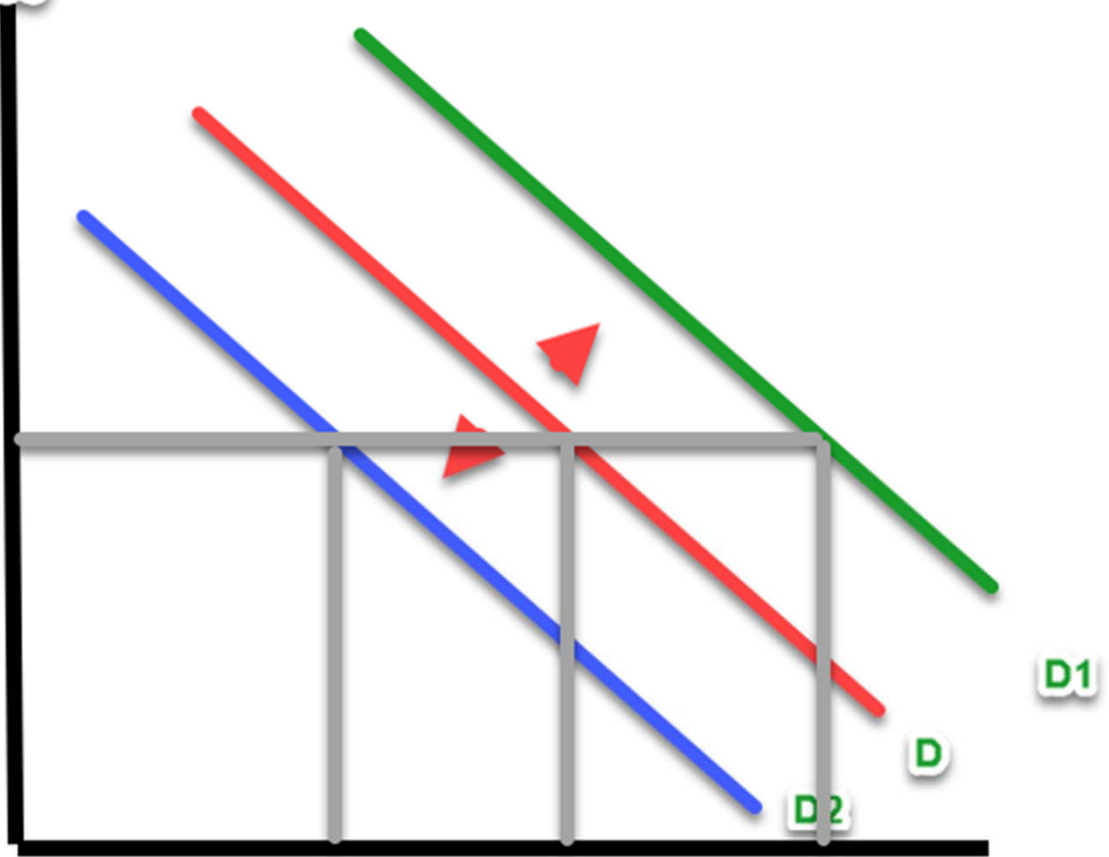
Quantity

Price



Quantity

Price



Quantity

# Do Market Dynamics Change?

- \* These are not your Dad's Markets!!
  - \* Global Participation facilitated by Technology and the fact that production has expanded globally.
  - \* Much more transparency in regard to what is happening throughout the world.
  - \* Much less transparency as to “who is doing what, buy and selling”.
    - \* Why is that true?

# Do Market Dynamics Change?

- \* More vertical integration in some markets
- \* Less vertical integration in other markets
- \* What about the impact of Commodity Funds?
  - \* The ag producers best friend?
    - \* Fade them!



\* If You are using the position why does margin and/or margin calls bother you???

-- Emotion

-- Cash Flow : You have got to be kidding?

-- Net Price: No way.

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# What does a margin call really cost you in \$\$?

- \* Example:

- \* Producer places the following hedges on corn

- \* Feb 1                    4 contracts 3.95
    - \* Mar 1                    4 contracts 4.10
    - \* April 1                   4 contracts 4.25
    - \* May 1                    4 contracts 4.40
    - \* June 1                    4 contracts 4.90
    - \* July 1                    4 contracts 5.20
    - \* Aug 1                    4 contracts 5.50

- \* October 1, all contracts offset at 5.25

# What does a margin call really cost you in \$\$?

- \* What is the net price of the corn?
- \* Most important let's walk through the margin calls.
  - \* Total amount of capital?
  - \* What is interest on the money at 5% interest?
- \* Let's calculate it.

# What has not changed?

- \* Lack of understanding of basic grain merchandising principals by grain producers.
  - \* Can be very beneficial to understand and use
  - \* Makes on farm storage one of the best return on investments “on the farm”.
  - \* But if you don’t understand the principals, then it will quite likely be a poor return on investment.

# What has not changed?

- \* Emotions of Making Marketing Decisions
  - \* Not life and death decisions
    - \* Those should be emotional
- \* The problem is that we just avoid making marketing decisions
  - \* Put them off until we are forced to market
  - \* Absolutely the number one issue for producers
- \* It many cases simply market by default
  - \* “When I need the money”

# Marketing vs Production

- \* Marketing never replaces production
- \* Good marketers understand that efficient production is critical to the long-term success of an operation.
  - \* I can't get my cost of production any lower?? NO, NO, NO.
- \* Good marketers understand that good marketing management enhances profitability because it can provide tremendous opportunities to expand and at the same time reduce the risk of failure.

# Fundamentals

- \* The two most important fundamentals
  - \* 1) We don't know nothing about the future.
    - \* And don't pretend that you do
  - \* 2) The market does not give a damn what your cost of production is!

# Fundamentals

- \* Ultimately they are the only thing that matters in determining price, BUT
  - \* They are constantly changing every second
  - \* We really have tough time understanding the dynamics of what we know and what is changing
  - \* Measuring demand is extremely difficult



# Technical Analysis

- \* The challenge of fundamentals is why many resort to technical analysis.
- \* There are very few “pure technicians” and they are more successful selling subscriptions than making profitable trades.
- \* “Charts don’t make it rain in the Corn Belt”

# What tools should I use?

- \* All of them if you can.
- \* “Will buying put options solve all of my marketing problems”?
  - \* NO, NO, NO
  - \* Actually a very poor marketing strategy in a lot of situations
  - \* Bankers “love” put options
    - \* Why?
    - \* Fortunately this is changing.

# How Does Margin Work?

Why does it drive us crazy??

\* If You are using the position why does margin and/or margin calls bother you???

-- Emotion

-- Cash Flow : You have got to be kidding?

-- Net Price: No way.

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