

Farmers advised to use a hedge strategy

The original design of commodity futures markets was to help farmers and other agricultural producers improve their marketing and purchasing activities through the use of hedging strategies. Hedging is taking a position in the futures market as a temporary substitute for the sale or purchase of the actual commodity or crop. Hedging acts to fix prices now for anticipated future sales or purchases thereby reducing the risk of price changes.

You may want to use a hedge strategy if you want to protect against the price risk inherent in a current or intended cash market position - for instance, an anticipated harvest. The result of a futures hedge is that any decrease in the value of the cash market position will be offset, more or less, by an increase in the value of the futures position. For example, a farmer who plans to sell his crop at harvest time can get protection from the risk of any decrease in price by selling futures contracts when he plants his crop in the spring. Prices of cash markets and futures markets usually move together so that when the cash market falls, the futures contract prices fall as well. If the cash

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Dollars and Sense



For example, a livestock producer makes regular purchases of corn as feed for his cattle. To lock in the price of feed over the year the livestock producer buys corn futures contracts. If, when the producer takes actual delivery of the corn, the price has increased, the extra cost is more or less offset by the profit on his futures contracts when they are sold. In this way the producer can fix the price of his feed input.

Producers who use hedging strategies in commodity markets have minimized the price risk associated with the ownership of specific commodities and often bankers are willing to lend funds to the hedging farmer on improved terms.

market price is depressed at harvest time, this lower price will be more or less offset by the gain in the futures contracts position when it is liquidated at a lower price. The short or selling hedge can be used to predetermine the producers return from the sale of the harvest.

Hedging can also be used to protect against the price risk of an intended purchase of a product, being used by farmers and producers when they buy commodities throughout the year. In the long or buying hedge the purchase of a futures contract acts as a temporary substitute for the intended purchase of a cash commodity and acts to fix the price of the cash pur-

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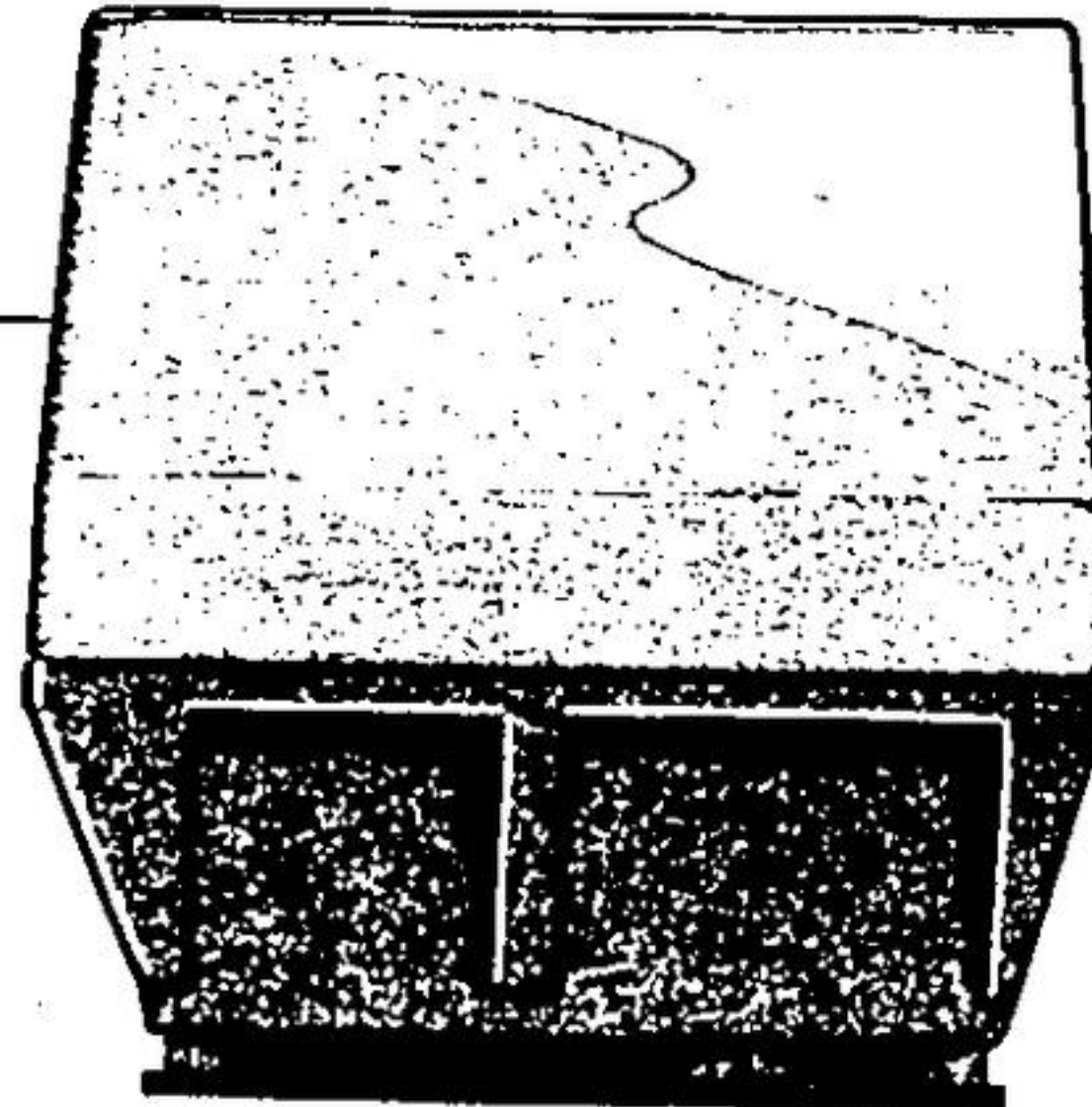
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