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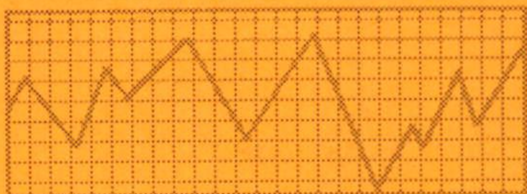

WEEKLY OUTLOOK

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PRICING NEW CROP SOYBEANS

Soybean market fundamentals have generally deteriorated since last fall. The final estimate of the size of the 1990 crop in the United States was 100 million bushels larger than the estimate made last October. The rate of domestic soybean crush was record large in September and October, but dropped below the rate of a year ago in December, January, and February as soybean meal exports declined. In February, the USDA confirmed that the 1990 Brazilian crop was 25 million bushels larger than previously estimated. The projection of stocks at the end of the 1990-91 marketing year (August 31) has grown from 175 million bushels last October to the current level of 320 million bushels.

The price of soybeans has generally followed the declining fundamental picture. July 1991 futures, for example, traded as high as $6.78½ per bushel in early October, but declined to a low of $5.76 in mid-January. Prices managed a bit of a rally in December on the basis of concerns about South American planting progress. In the past week, prices moved a bit higher once again as concerns about dry weather in southern Brazil surfaced. July futures closed at $6.10 on March 1.

Large inventories of soybeans and prospects of large free stocks at the end of the year have forced a relatively large carrying charge in the soybean futures market. That carrying charge persists into the new crop contracts, resulting in a large premium of new crop prices over old crop prices. On March 1, for example, March 1992 futures closed at $6.47 per bushel, $.60¼ above March 1991 futures. That is a premium of slightly more than 10 percent. The premium offers an opportunity to forward price some of the 1991 crop. With November futures at $6.25 per bushel, many eastern Corn Belt producers could price harvest delivered soybeans at $6.00 or higher. That will prove to be an attractive price if South American production escapes significant weather damage, U.S. producers increase acreage, and the 1991 growing season is favorable. Prices will move higher, however, if weather problems develop.

Price patterns since 1975 show that the price recovery out of the winter doldrums usually comes in stages. Prices have peaked in the April through September period in 13 of the past 15 years. Forward pricing new crop soybeans on the spring rally has generally proven profitable. While it is tempting to sell the first stages of that rally, patience has generally been rewarded. The window of pricing opportunity can be fairly narrow, however.

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Several strategies can be used to price new crop soybeans on spring price rallies. One is the scale up strategy. This involves selling relatively small amounts in the early stages of the rally and larger amounts at higher price levels. Cash contracts might be used where basis levels are strong. Futures could be used where basis is currently weak. Futures might also be preferred to cash contracts to provide more flexibility in the pricing decision. Re-ownership is generally easier with futures.

There are generally two risks with the scale up strategy. One is that a substantial portion of the crop is priced and severe problems later in the year push prices higher and/or reduce the size of the crop for the individual producer. The second is that prices turn sharply lower before the desired level of pricing is reached.

Options may offer an alternative to manage part of the risk of forward pricing. Buying put options rather than forward pricing or buying call options to offset forward sales will allow the producer to establish a minimum selling price and to participate in higher prices later on, should they occur. Option premiums, however, tend to be relatively high for new crop contracts because of the time value. Costs could be reduced by using options on summer futures, or employing spread strategies. A popular spread strategy is to replace forward sales with a call option and to sell call options with a higher strike price. The premium received for selling the call offsets some of the cost of purchasing the call, but also establishes a ceiling on the net price received.

Regardless of the method used, history suggests that some forward pricing of the new crop during the spring/summer months should be considered.

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