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HAVE CORN AND SOYBEAN PRICES PEAKED?

The poor performance of corn and soybean prices following the USDA's November *Crop Production* report have led some analysts to conclude that those prices have peaked and the "long tail" of the price decline has begun. This would be consistent with the price pattern in other short crop years when prices peaked before or shortly after harvest. In addition, history suggests that prices often peak when the fundamentals of supply and demand remain very supportive, at least on the surface. That is, end users have often made the adjustment in consumption necessary to ration a short crop before those adjustments are apparent in public information sources. A relatively strong technical case for a November peak could be made this year if nearby futures close lower for the month, after establishing new highs during the month. In addition, once the large speculative traders have liquidated their positions, it is often difficult to attract enough speculative buying to establish new highs later on. Another "event" is usually required to attract such buying.

Those analysts who still expect new highs in the corn and soybean markets basically believe that the likelihood of another "event" is significant. One possibility is that domestic and world demand is much stronger than in previous short crop years and that end users have not yet made the necessary adjustments to the reduced supply. This argument is supported by a continuation of large export sales and reports of large commercial buying of futures on small price declines. If demand has not yet been rationed, higher prices may yet be required.

Other factors also hold the potential for higher prices. With world grain stocks at extremely low levels, the market would likely respond to any threat of a production shortfall in the coming year. The U.S. hard red winter wheat crop was seeded in less than ideal conditions in many areas and remains vulnerable, as always, to winterkill. The South American soybean crop is being planted and all of the uncertainty of the growing season exists. Even with increased crop acreage in the U.S. next spring, excellent yields will be required to maintain inventories at respectable levels.

We generally believe that corn and soybean prices can be maintained at relatively high levels for the next two or three months and that new highs are likely. However, the implications of misreading the current situation are significant. If prices have peaked, aggressive pricing of 1995 and 1996 crops is warranted. If price strength can be maintained, patience is required, particularly for the 1996 crops. Another argument for moving slowly on pricing 1996 crops is that the prices currently being offered are not especially high. December 1996 corn futures have had a high of only $2.83 and are currently trading under $2.80. November 1996 soybean futures have had a high of $6.77 and are currently trading under $6.70.

As pointed out before, pricing of the 1996 crops can be accomplished by first selling 1995 crop futures with intentions of rolling the sale forward to 1996 crop futures if and when the spreads become more favorable. The primary risk of that strategy is that spreads remain wide, as they did in 1984. Another general strategy is to use options to price a portion of the 1996 crops. Producers could buy put options to establish a minimum price. Alternatively, producers could forward price 1996 crops and replace those sales with the purchase of call options.

The primary disadvantage of options is the cost. Currently, the premium for a $2.80 December 1996 corn put option is $.19 per bushel. Purchase of that option would establish a minimum cash price of $2.61 minus basis at the time of pricing. Similarly, a $6.75 November 1996 put option has a premium of about $.43, resulting in a relatively low minimum price. Call options are also relatively expensive because of a full year of time value. For those, who believe that corn and soybean prices will at least remain firm for the next two or three months, option strategies may be more favorable later on.

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