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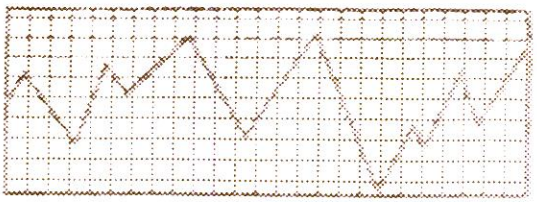

WEEKLY OUTLOOK

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HOW TO PRICE CORN FOR 1996 AND BEYOND

The debate continues as to whether corn prices have peaked for the 1995-96 marketing year. While there is no way to know for certain, until looking back with hindsight, another round of higher prices seems likely. The price level and the timing are very difficult to predict. Highs reached during previous short crop years can serve as price objectives, but there must be fundamental reasons that cause prices to seek those levels. The desire by producers to achieve the highest price is tempered by the possibility of loosing out on profitable forward sales if normal crop production next year pushes prices lower.

Based on the USDA supply and demand estimates, rationing of over 1 billion bushels of corn use must occur during the 1995-96 marketing year. Most of the reduction will come in the feed and residual category. While statistical error can account for some of the variation in feeding rates, the number of grain consuming animal units (GCAU) must be reduced by about 3 percent. Combining all classes of livestock into GCAU's is a way of comparing feed consumption of all livestock. This will be the first time in 10 years that the reduction in feed use cannot be accomplished by just reducing feeding rates and the level of ending stocks. While the rationing process has undoubtedly begun, there is no current evidence of liquidation of livestock herds, or reduced average marketing weights of livestock. The December *Grain Stocks* report, released on January 11, will provide the first official indication of changes in feed and residual use. If feed rationing is not apparent, prices will have to go higher to accomplish the task.

With current corn supply and demand conditions, the March 1996 futures may approach the 1988 high of $3.60. Consider using a scale-up sales program for 1995 production with March 1996 futures around $3.50, with more aggressive sales when a technical sell signal is given. The technical signal could be breaking of a short term trend line or violation of a moving average.

Selling the remainder of the 1995 crop is relatively easy. Make a cash sale (or cash-forward sale if the price warrants) or hedge-to-arrive if you feel the basis improvement in your area will more than cover the extra cost of storage. Expect a very strong basis before new crop corn supplies become available. For the 1996 corn crop, you could forward cash contract with your local elevator, or sell December 1996 futures near $3.00 (with March 1996 futures near $3.60). The risk is that crop production problems somewhere around the world, coupled with low stocks and strong

demand, could send corn prices to record high levels above $4.00 per bushel. This risk can be managed by purchasing call options as shown in the example below.

Some analysts recommend pricing the 1996 corn crop by selling July 1996 or September 1996 futures and later rolling the hedge into December 1996 futures. The attraction is the positive spread, currently around 50 cents, between July and December, which normally collapses before the July contract expires. If rationing of demand does not occur before summer, or crop problems develop, the spread could widen to $1.00 or more and not recede before the July contract expires. This would require huge margin calls and reduce the net price received. This risk can be controlled by purchasing out-of-the-money call options. Currently, the premium on a $3.50 July 1996 corn call option is around 10 cents. The premiums on call options increase as the futures price increases, or the option volatility increases. The option volatility is positively influenced by the activity in the futures prices. The call options can be purchased ahead (in anticipation) of the pricing decision, as long as you have a plan and stick to it.

If you wish to make multiple crop year sales, simply sell larger quantities of deferred futures (equal to your expected production in future years) and continue to roll the contracts forward into the lead-month futures, eventually getting to December 1997 and December 1998 futures. When you sell a futures contract, you established a basic (futures) price level. From that point onward, the outcome will be influenced by the spread , slippage, commission charges, and basis. The spread is the difference between the exit price of the near-by futures and the next futures contract. Slippage is the loss in the spread as the contract is rolled forward. The basis is the difference between the cash price at harvest and the December 1997 and December 1998 futures. If you have storage, you can analyze the harvest basis and spreads and determine if you wish to continue the hedge with stored grain. Multiple year sales can require a large line of credit for margin calls, but will lock in some very profitable prices with normal production. Producers with limited experience in using the futures and/or options markets should seek professional advise before attempting such plans.

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