

Farmer's Corner



May/June 2013

Number 3

Volatility Reigns

During a recent farm marketing presentation, a picture (fig. 1) of corn prices was shown to a group of producers, followed by four questions.

- 1. What word best describes this picture?**
The group responded in unison: volatility.
- 2. Has volatility been good or bad for production agriculture?**
The group responded: good.
- 3. Have you enjoyed marketing in this environment?**
The group responded: no
- 4. Do you expect volatility to continue?**
The group responded: yes.

To summarize, the group thought that volatility has been beneficial to their outcome, they expect prices to remain volatile, but dislike marketing in this environment. No doubt such sentiments are shared by farmers in general today. What steps can producers take to reap the financial benefits of volatile prices and yet feel good about their decisions?

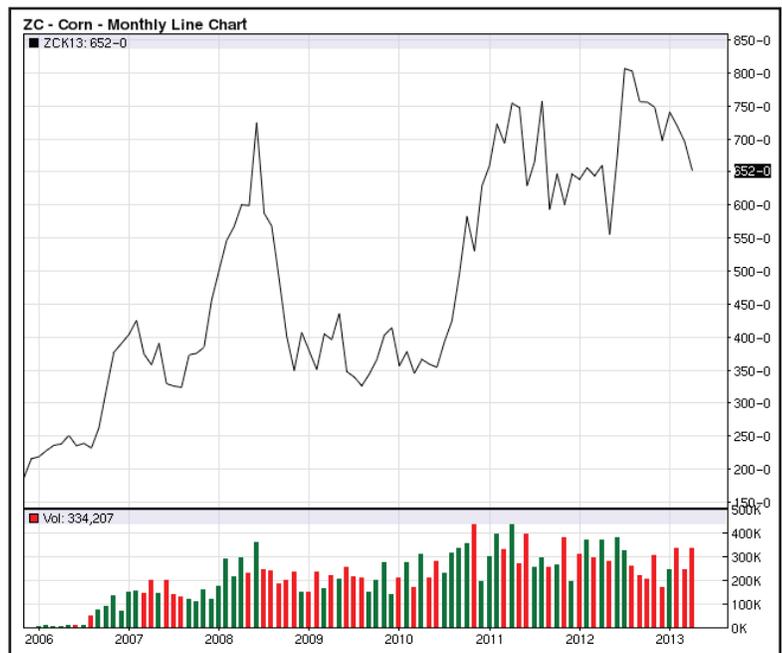


Fig. 1

If we were to analyze the reasons why producers dislike marketing grain during times of volatile prices, we would probably learn that making marketing decisions and later regretting them would rank near the top. Countless astute farmers have made good business decisions, locking in good profits, only to be “outdone” by their neighbors who let things happen, so to speak, and captured higher prices, with little or no planning. That is frustrating but is not the norm over long periods of time. It may be enlightening to examine the truly rare set of circumstances that have occurred during the last few years, probably contributing to record high prices and profit margins beyond anyone’s wildest dreams.

The following analysis is not meant to make any price predictions or to suggest any particular outcome as we move forward. We intend only to create awareness of the extreme circumstances we have experienced in production agriculture and to help producers to become more comfortable dealing with volatility.

National average corn yields (fig. 2) have declined for the last three consecutive years, with the drought-reduced 2012 crop being the lowest yield in 17 years. In the last 30 years, this is the first time that the national average corn yield has dropped for three years consecutively.

Total corn supplies (fig. 3) peaked in 2009 and have declined for three consecutive years. In the last 40 years, this is only the second time that supplies have declined for three consecutive years, the last occurrence being '86, '87 and '88.

The results of the above phenomena are reflected in the low stocks/usage ratio (fig. 4). Usage has declined slightly less than supplies, resulting in the tightest stocks/usage ratio in 17 years.

The corn stocks/usage ratio has declined for four years in a row, the first such occurrence in 37 years. There is an obvious inverse relationship between the stocks /usage ratio and price; low stocks/usage ratios are accompanied by higher prices, while high stocks/usage ratios lead to lower prices.

What can we conclude by looking at these statistics? A series of extreme circumstances have converged during the last three or four years resulting in continued high prices and record profit margins in production agriculture. Who could have imagined such a series of events would occur and lead to such prosperity? Missing out on these opportunities by “selling too early” has been frustrating to some marketers, but such frustration could easily be replaced by total disbelief in how rapidly extreme profits could evaporate and be exchanged for negative profit margins. Volatility works both directions, up and down.

Consider that, as of this writing and if the weather cooperates, the planted corn acreage in 2013 is expected to be the largest planted acreage since the 1930s. As you are all aware, seed technology and cultural practices are making huge advancements. Example: the drought stricken 2012 corn crop was the eighth largest crop in history grown during the worst drought in 50 years. An average 2013 growing season has the potential to yield a large crop and an above average growing season will yield a huge crop. Couple this possibility with the fact that high prices have destroyed significant demand for corn (18% reduction in four years) and history proves that demand is restored slowly over a period of years.

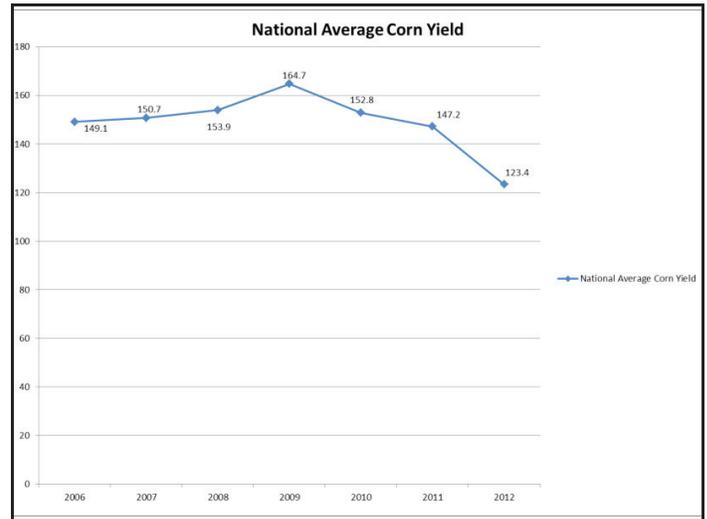


Fig. 2

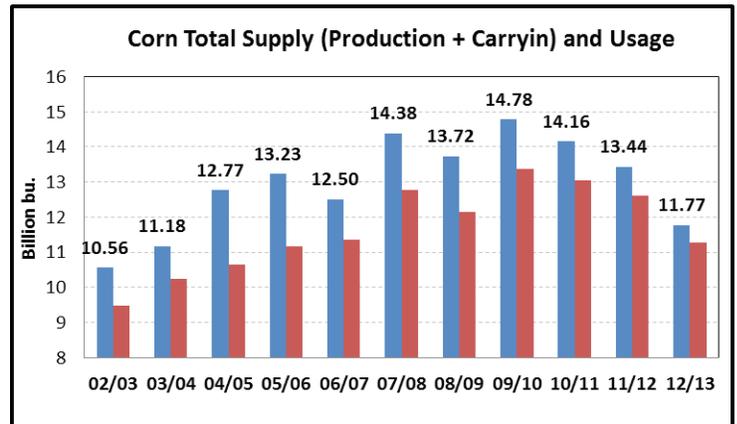


Fig. 3

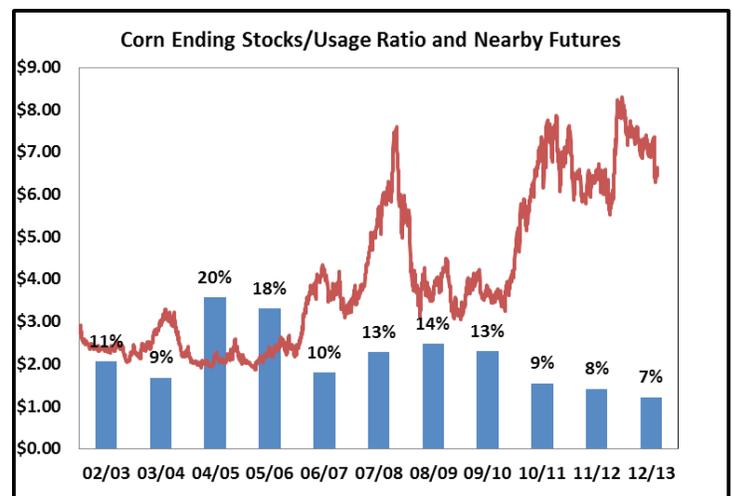


Fig. 4

A sage once said that “What we learn from history is that we don’t learn from history.” This saying may apply to the masses of humanity, but it need not apply to you and your grain marketing. Take a look at the growth in the stocks/use ratio (fig. 5) after the last drawn down in supplies 17 years ago. When production rebounded, the stocks/use ratio doubled in one year, almost quadrupled in four years and prices reacted accordingly. The stage is now set to experience the most dramatic one year turnaround in corn stocks/use ratio in history, if we have a good growing season. If we have another crop disaster in 2013, no doubt a new chapter in price volatility will go down in history.

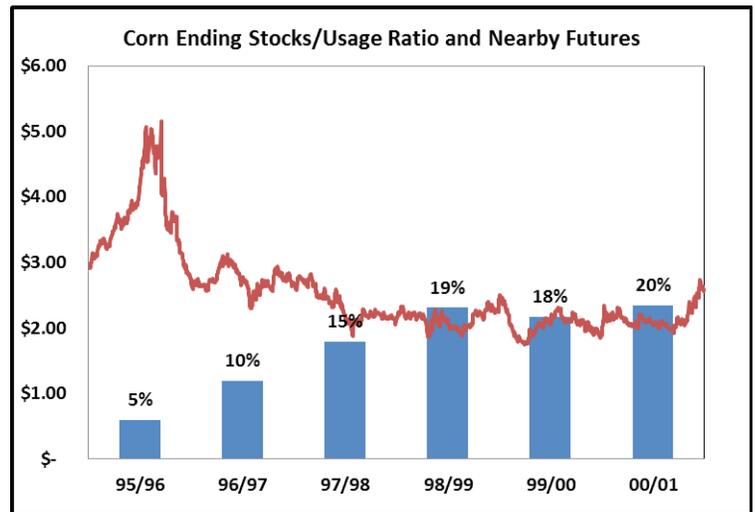


Fig. 5

So, how does one continue to reap the benefits of expected price volatility and enjoy doing so? As of this writing both new crop 2013 corn and soybean prices are trading at profitable levels. The investment in inputs for the upcoming crop is substantial. How can you afford not to at least sell enough bushels to cover a meaningful portion of the cost of production, given the potential for dramatic volatility during the upcoming season?

Here is an example of a simple tool that we can offer you to take a snapshot of what current prices may mean in your operation. We recommend evaluating prices in this way as a means to avoid the emotional roller coaster of watching prices and to discover the financial impact of current prices.

Gross Revenue and Profit Calculator										
CORN										
Price	\$5.00									
Yield	175									
Acres Farmed	500									
Gross Revenue	\$875 per acre \$437,500 all acres									
Cost	\$600	\$625	\$650	\$675	\$700	\$725	\$750	\$775	\$800	\$825
Return Per Acre	\$275	\$250	\$225	\$200	\$175	\$150	\$125	\$100	\$75	\$50
Return All Acres	\$137,500	\$125,000	\$112,500	\$100,000	\$87,500	\$75,000	\$62,500	\$50,000	\$37,500	\$25,000
Breakeven Bushels	120	125	130	135	140	145	150	155	160	165

As always, we want to be your partner in marketing your crops and will be happy to share with you some simple tools that will help you to identify marketing opportunities and to make them reality in your operation. We wish you continued success as you plant, care for and market your 2013 crop production!