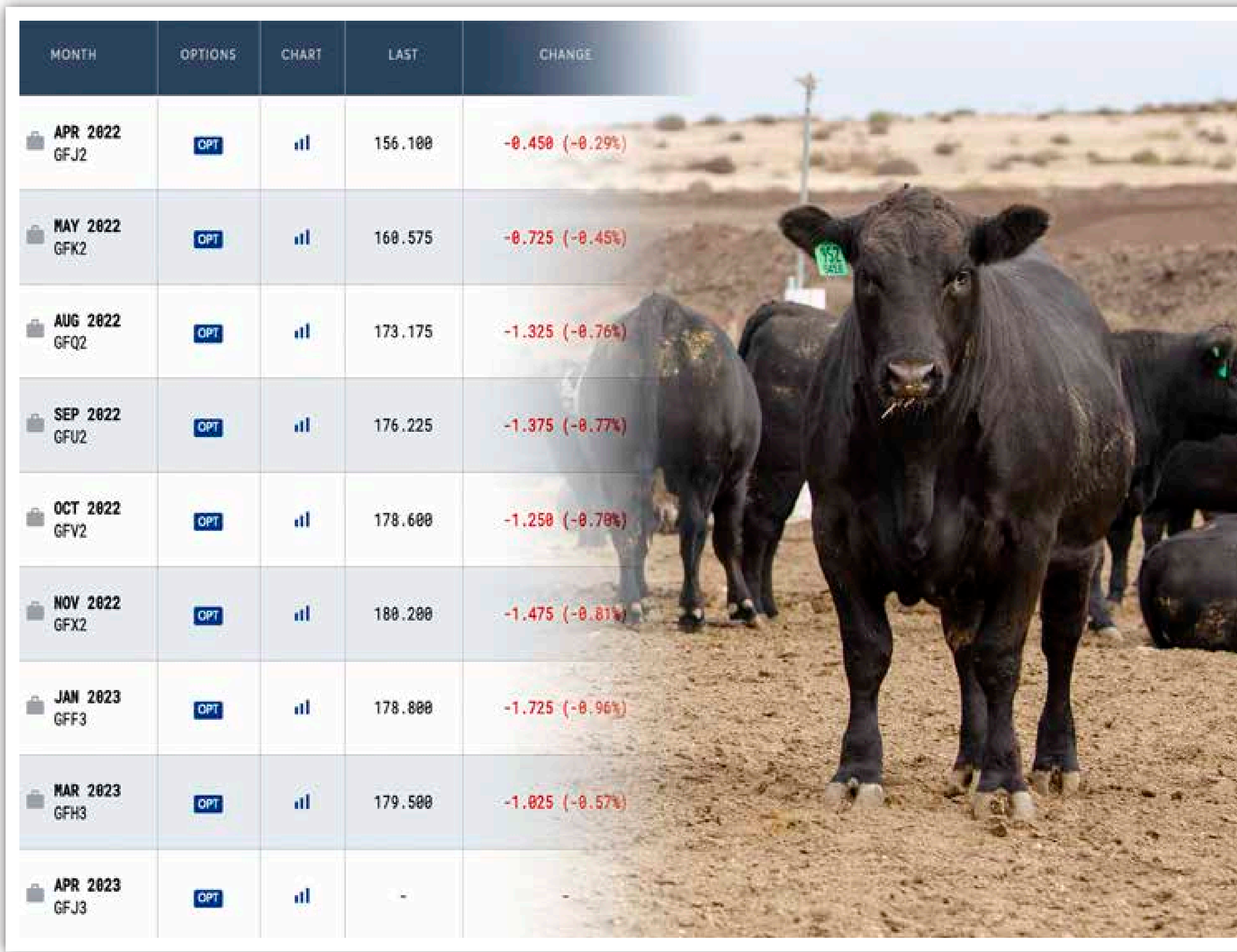


MONTH	OPTIONS	CHART	LAST	CHANGE
APR 2022 GFJ2	OPT		156.100	-0.450 (-0.29%)
MAY 2022 GFK2	OPT		160.575	-0.725 (-0.45%)
AUG 2022 GFQ2	OPT		173.175	-1.325 (-0.76%)
SEP 2022 GFU2	OPT		176.225	-1.375 (-0.77%)
OCT 2022 GFV2	OPT		178.600	-1.250 (-0.70%)
NOV 2022 GFX2	OPT		180.200	-1.475 (-0.81%)
JAN 2023 GFF3	OPT		178.800	-1.725 (-0.96%)
MAR 2023 GFH3	OPT		179.500	-1.025 (-0.57%)
APR 2023 GFJ3	OPT		-	-

BANKING ON THE FUTURE

Learn how to navigate the futures market and price protection.

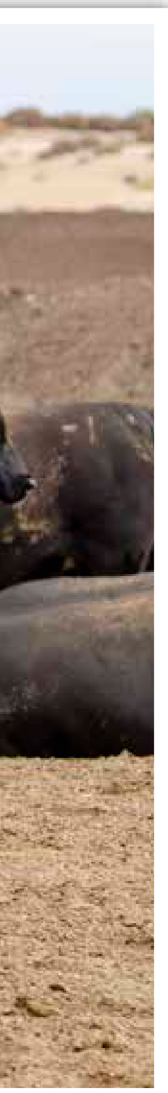
by Troy Clevenger, Jimbo Mercer, Joe Kovanda and Jason Kraft, Compass Ag Solutions

Whether you are marketing at weaning or preconditioning, the futures market will affect the price you receive for your calves. Most producers say they wished they better understood how the cash and futures markets relate and how the futures markets affect cash cattle markets. What information is available from the futures markets that can help guide producers' marketing decisions? How can cattle owners protect their high-quality Angus cattle and take actions that lead to higher profits?

Understanding futures

Futures markets forecast the most accurate price estimate for a commodity at a future date. These forecasts are constantly affected by factors that influence the supply and demand of specific commodities.

Geopolitical events, weather patterns, social issues, politics, etc., all create significant fluctuations in the future availability and consumption of commodities. The futures market translates these fluctuations into changes in the future commodity price expectations.



While speculators seek to profit on market moves from buying and selling, hedgers use futures markets to protect the price of physical assets they own or purchase from these price fluctuations. For all producers along the supply chain, the futures market price influences the cash commodity value and is an effective tool for business and marketing decisions.

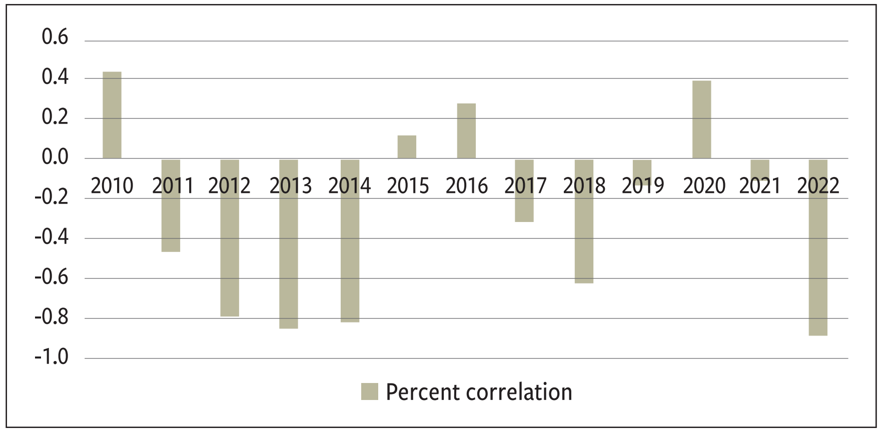
Feeder-cattle specific

The feeder-cattle futures are structured to settle exactly to the "cash" feeder steer index. The feeder steer index is a daily calculated, weighted average of cash sales of steers originating from 12 central states and weighing between 700 and 899 pounds (lb.). The average weight of the index is about 800 lb., so lighter or heavier animals' prices are included in the average.

Linking feeder-cattle futures to the cash index is an intentional design to ensure that futures prices reflect cash prices at the time the cattle are sold — making futures an effective forward-marketing tool for your calves and feeder cattle.

Calf and feeder-cattle prices are challenging markets to navigate. Feeder-cattle futures reflect cash markets and future expectations for cash markets. Additionally, feeder-cattle futures are heavily influenced by the fed-cattle and corn futures markets. These three commodities are interrelated, and their prices are the major cost components to create fed-cattle values: feeder-cattle prices + corn prices + (non-corn feed, medicine, labor, interest cost, etc.) = fed-cattle value.

Fig. 1: Correlation of corn and feeder-cattle futures, adjusted to remove influence of live cattle



Fed-cattle supply and demand is the dominant driver for feeder-cattle and calf prices. From 2000 to now, feeder-cattle and fed-cattle futures had a 95% correlation. As fed-cattle futures prices increase, feeder-cattle futures prices also increase with 95% interdependence.

Corn futures prices, however, have an inverse correlation with feeder-cattle prices. As the price of corn increases, the cost to transform feeder cattle into fed cattle increases, which decreases the buyers' bid prices for feeder cattle.

Amidst this year's escalated corn prices, feeder-cattle and corn futures had a −34% correlation when adjusted to remove the influence of fed-cattle prices. The negative correlation implies that rising feed prices result in falling calf and feeder prices 34% of the time.

Corn and feeder-cattle prices have similar negative price correlations throughout history, particularly in years when corn prices go up or down significantly. Feeder-cattle, fed-cattle and corn futures prices offer truly relevant information to calf marketing decisions.

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PHOTO BY SHAUNA HERMEL

Feeder-cattle futures are heavily influenced by the fed-cattle and corn futures markets.

Price protection

Risk management and marketing strategies, combined with futures information, help the producer achieve dependable profits and capitalize on market opportunities. History has proven, especially in recent years, the unpredictability of the market. This uncertainty causes significant fluctuations in the value of your cattle and increase potential financial losses, sale price uncertainty, and the overall risk of calf/feeder production.

Regardless of how high-quality your cattle are, their price is a function of the feeder-cattle market. Operational efficiencies, genetics and performance improvements are incredible efforts that lead to better profitability.

However, market exposure can severely dampen or even eliminate those benefits. If the commodity market goes lower, the net price for your value-added calves, seedstock and replacement bred stock will also go lower.

Several financial tools can be used to manage market price risk. The Livestock Risk Protection (LRP) program protects from downside price risk while providing the opportunity to capture higher prices. LRP is likely the most straightforward form of price protection for feeder calves, and it overcomes common objections to risk management, like unpredictable cash flow, margin requirements, upfront costs and commission fees. On average, LRP is 25% cheaper (about $15 per head) than a CME (Chicago Mercantile Exchange Inc.) put option, while functioning the same way, and there is no added commission fee.

The cost to buy price protection is fixed each day with no additional financial margin requirement, and the insurance cost is not due until after the cattle are sold. This tool is offered through the USDA, and its pricing is directly correlated to the cattle futures closing prices each day.

Futures market prices are the best current forecast of future cash feeder-cattle values. This makes them important to cattle owners.

Here is an example of how you could use tools in current market conditions to apply a risk strategy:

At this writing, producers could lock in a higher price floor on their calves shipping in December than they could have last year, even with the $40-per-head LRP cost included.

Many producers are uncomfortable with the amount of uncertainty in the cattle markets and the intensifying drought conditions, which, among other factors, is contributing to the uptrend in corn. Producers who don't want to be exposed to these factors and want a dependable sale price for their cattle in December can protect themselves with LRP.

Later in the summer, if we move through the excess fed-cattle supply and the national cow herd continues to be liquidated, the feeder market could gain momentum and fall prices could move higher. If that occurs, producers would have the opportunity to add several dollars per hundredweight (cwt.) to their profit margin using a forward contract or video auction.

Or producers can wait, keep their top side open, and see if the market keeps going higher. Producers who have established a floor price for their cattle with LRP find it is much easier to patiently wait for higher prices because they know what the worst-case scenario could be.

Despite ever-changing current conditions, cattle owners can use risk protection tools to help them make marketing decisions.

In this example, Angus producers can establish a price floor for their cattle, even with high grain prices, and still take advantage of a future rise in the market months later. The futures markets do influence the cash price of your calves down the road. They also help price LRP insurance, which is one more tool producers can use to manage risk as different market conditions arise.

Futures market prices are the best current forecast of future cash feeder-cattle values. This makes them important to cattle owners. Recognizing what current futures prices mean for one's future sale of calves or feeders is one step in managing cattle ownership financial exposure. A second step is to use price tools to expand the time horizons for protecting your future cattle sale prices beyond the timing offered by traditional cash cattle marketing (video sales, private treaty and auctions). Managing cattle price risk is one of the most crucial factors for ensuring the sustainability of ranching operations.

Editor's note: This article was commissioned for the *Angus Beef Bulletin*. Troy Clevenger, Jimbo Mercer, Joe Kovanda and Jason Kraft are risk managers with Compass Ag Solutions, a dedicated cattle risk-management company. For more information visit *https://compassagsolutions.com/*.