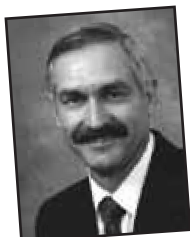

Market Advisor

by **TIM PETRY,** *livestock marketing economist, NDSU Extension*

Volatile prices and livestock risk protection insurance

I am writing this column on July 20, and in just over a month fall feeder-cattle futures market prices have fallen about $27 per hundredweight (cwt.). By the time you read this article, feeder-cattle prices will have changed, but I suspect prices will not have returned to mid-June levels. Feeder-cattle markets were expected to face record volatility this year with anticipation of a record corn crop and how weather conditions would affect it.

All market classes of beef cattle set all-time record high prices in 2011, and started 2012 at even higher levels. With the historically short supply of feeder cattle available in 2012, expectations for another record price year were looming. However, many feeder-cattle producers were also asking about what catastrophic events could come along to cause prices to decline significantly, as has happened several times in the past decade.

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Bumps in the road

The first bump in the road was the lean, finely textured beef (LFTB) social media fiasco that certainly negatively affected fed-cattle prices and negatively affected feeder-cattle futures in March and April.

Furthermore, the discovery of BSE (bovine spongiform encephalopathy) in a U.S. dairy cow in April temporarily affected the market. By late April, fall feeder-cattle futures prices had fallen $14 per cwt. off the early March seasonal high. By mid-June, prices had climbed back up to just $2 per cwt. shy of the early March seasonal high, and optimism for historically high prices was evident.

> With record prices, volatility and uncertainty, price risk management for producers who market feeder cattle should be part of a good marketing plan.

As it turned out, those issues paled in comparison to the devastating drought that hit much of the country and, in particular, the Corn Belt. From mid-June to mid-July, December corn futures soared $2.70 per bushel (bu.) as reports of deteriorating corn crop conditions surfaced. The $27 decline in feeder-cattle futures prices was right on target with the old rule of thumb, "for every 10¢ per bu. change in corn prices — change feeder cattle prices $1 in the opposite direction."

Livestock risk protection insurance

With record prices, volatility and uncertainty, price risk management for producers who market feeder cattle should be part of a good marketing plan. Several tools are available, including futures, futures market options, video and Internet auctions, forward contracts, and livestock risk protection (LRP) insurance. I want to talk more about LRP insurance because it is relatively new and can be used by producers with small numbers of cattle.

LRP is offered by the USDA Risk Management Agency (RMA) to cattle producers in 37 states. LRP was designed to insure against declining market prices. It functions similarly to futures market put options, except that the insurance contract is purchased from an approved crop insurance agent instead of a futures market broker.

LRP insurance is market-based, so coverage prices and premiums change daily. Producers select coverage levels that range between 70% and 100% of an expected price, similar to futures market options strike prices. Coverage prices and premiums are posted daily on the RMA website at *www3.rma.usda.gov/apps/livestock_reports*. RMA subsidizes the premiums by 13%, so the actual cost is lower than shown in the table.

Contracts are available for several market classes of feeder cattle, including less than 600 pound (lb.) beef steers, more than 600 lb. beef steers, less than 600 lb. beef heifers, more than 600 lb. beef heifers, less than 600 lb. Brahman cattle, more than 600 lb. Brahman, under 600 lb. dairy cattle, and over 600 lb. dairy. Contracts are also available for fed cattle, swine and lambs.

LRP contracts may be especially useful for producers with smaller numbers of livestock to be insured against price declines, because no minimum number is required. The maximum number that can be insured in a crop year (July 1-June 30) is 2,000 feeder cattle.

Not enough space exists in this column to explain the details of LRP. More information is available at *www2.rma.usda.gov/livestock*. LRP presentations are available on my website at *www.ag.ndsu.edu/livestockeconomics/presentations*.

I have been conducting research on LRP strategies for North Dakota-raised feeder cattle since contracts became available in October 2004.

One strategy involved buying an LRP contract on July 15 each year for under 600 lb. feeder steers to be marketed on Nov. 15. Cash market prices for calves usually decline seasonally from July into November. In years 2005, 2010 and 2011, LRP contracts did not pay indemnities in this strategy. Both 2005 and 2011 were record high price years for steer calves in North Dakota and contra-seasonal increases in prices occurred in all three years.

> LRP offers price protection when prices fall, and producers receive higher prices in the marketplace when prices increase.

In 2006, the LRP strategy added $5.38 per cwt. to the cash-market price for less than 600 lb. steers after paying the premium, with $1.35 added in 2007, $14.55 in 2008, and $5.51 in 2009. These years all experienced normal seasonal price patterns.

So, LRP offers price protection when prices fall, and producers receive higher prices in the marketplace when prices increase.

In 2012, July 15 was a Sunday, but on July 13 the less than 600 lb. contract offered a coverage price of $155.70 per cwt., at a $4 per cwt. premium for Nov. 9 maturity. Time will tell if that was a good investment.

Editor's note: *Tim Petry is a livestock marketing economist at NDSU Extension Service and the NDSU Agribusiness and Applied Economics Department.*

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