Local

Commodities a tricky market

May traders never see what they trade

By BARBIE WOELFEL
Battalion Reporter

It's undiscovered by many and ignored by those who don't understand it. But it's closely watched and dealt with by those who are experts.

This fascinating institution which has increased in popularity has made many "hedgers" and "speculators" millions. The system is known as the commodity futures market.

The futures market is the buying and selling of contracts to be delivered at a future time, usually eight to 10 months away from the purchase date. All contracts are the same in regards to quantity and quality but have different prices and dates of delivery, said the Commodity Research Bureau in Understanding the Commodity Futures Market.

"However, the average trader is rarely interested in taking or making delivery. Almost invariably, he closes out his position in futures delivery contracts before they mature," said the Commodity Research Bureau.

Contracts of wheat, grain (corn), oats and soybeans are traded in bushels. Cotton and beef are traded in pounds, said the Chicago Mercantile Exchange in Commodity Markets and Futures Prices.

The commodity futures market "is a simple affair. It is an organized market like the stock market, ... but fluctuates more widely because it is more sensitive to a wider range of economic factors," said the Commodity Research Bureau.

These sharp price changes are due to many factors such as weather, insects and diseases which may affect the growing season of the crop or the animal's feeding conditions. Other reasons for price changes include the demand for food along with international tension.

"There are three types of traders on the futures market," said Bradley Johnson, cash grain merchant for Cargil Inc., the largest grain dealer on the futures market. "There are commercial traders who are dominated by big grain companies, commission and brokerage houses such as Merrill Lynch who charge fees for

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their services and local speculators who are usually businessmen trading to make money."

The commercial traders are dominated by the "big five" grain companies which include Cargil Inc., Continential grain, Louis Dreyfus, Bunge and Garnac. These five must "hedge" — a protective procedure designed to minimize commodity and marketing and processing losses that are due to adverse price fluctuations, in order to stay in business and make a profit, said Johnson.

Individual farmers and grain elevator operators buy hedging contracts through commission brokers in order to minimize price risks of the cash market of which they normally sell their commodities.

According to Dr. Clive R. Harson, professor in the agricultural economics department at Texas A&M University, the perfect hedge for two contracts of wheat (one contract equals 5,000 bushels) for example, allows the cash and futures market profits and losses to break even.

The following example show how this "perfect hedge" is effective in covering price risk, said Harston.

Cash Market —

March 1 — farmer plants corn and expects to receive $2.60/bushel

Oct. 1 — farmer sells 10,000 bushels at $2.40/bushel after harvest and three months of storage

Loss of .20/bushel

Futures Market —

March 1 — farmer sells corn futures for November delivery at $3.00/bushel for 10,000 bushels

Oct. 1 — farmer buys back November futures contract at $2.80/bushel

Gain of .20/bushel

These types of contracts are used to cover the risk of prices rising and falling on the cash market which affect the intakes of profits drastically for large farmers who farm thousands of acres.

Of course, the futures market does not always produce a gain for the hedger. The futures price may go up, which will cause a loss to the hedger: therefore, he must put up a margin which is cash or collateral posted to the broker as a guarantee of of fulfillment of a futures contract which is not a part of the payment or purchase, said the Commodity Research Buraeu.

The speculating type of trader is usually a keen businessman who "anticipates the market rising and falling by closely watching what the farmers are doing. If they begin to expand production, then I speculate that the price will go down because there will be an excess supply, and if a cutback in production is seen, I expect an increase in price because the supply will tend to decrease," said Jimmy Kieschnick of Woodridge, Ill.

"Illinois, Iowa, and other surrounding states are the garden spot of the United States, and whatever these farmers decide to do, will usually alter the supply and demand for their products," Kieschnick said.

Kieschnick, a speculator himself, has no direct connection with any production of a commodity, but buys contracts when he thinks prices are too low and sells them when he thinks prices are too high. Several time, Kieschnick has made a large sum of money by his successful speculating.

Most agricultural products are traded on the Chicago Board of Trade. Brokerage firms own a membership on the board in order to participate. A hedger would trade on the board through one of these brokerage firms.

"At the Chicago Board of Trade, there are pits which are designated areas for certain agricultural products such as grain, wheat, cotton, soybeans, oats and feeder cattle,

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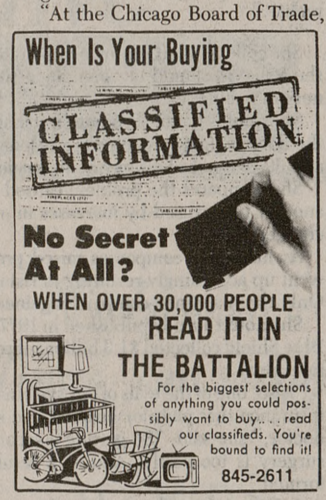
where buyers and sellers are screaming out prices in order to find a buyer or seller for his price. Once the buyer or seller has found another to make the trade of contracts, a simple nod of the head completes the deal," Johnson said.

The brokerage firm then calls the hedger reporting what his specific contract states in regards to price and delivery date. A hedger can do this in a matter of a few hours.

By dealing with imaginary contracts, amateurs are able to learn about the futures market by assuming that a contract was bought, said Barry Stevens, a student a Texas A&M from Lubbock.

When Stevens decides to buy an imaginary contract, he calls his father, Mike Stevens, a broker for Merrill Lynch in Lubbock, and sets the amount of contracts and the price he wishes to buy them at. He closely follows the price changes in the futures market as well as the cash market to see if he could have covered any price risks.

"You must know what you are dealing with and you must have money to back up your losses before you ever attempt to deal in the futures market," Kieschnick said. "Never play around with your grocery money or you'll lose everything."



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