MGGA INTERMEDIATE MARKETING CLASS NEWSLETTER

JULY 2015

Intermediate Marketing Workshop

Gary Brester, Department of Agricultural Economics and Economics
Joe Janzen, Department of Agricultural Economics and Economics
George Haynes, Department of Agricultural Economics and Economics (Extension Economics)

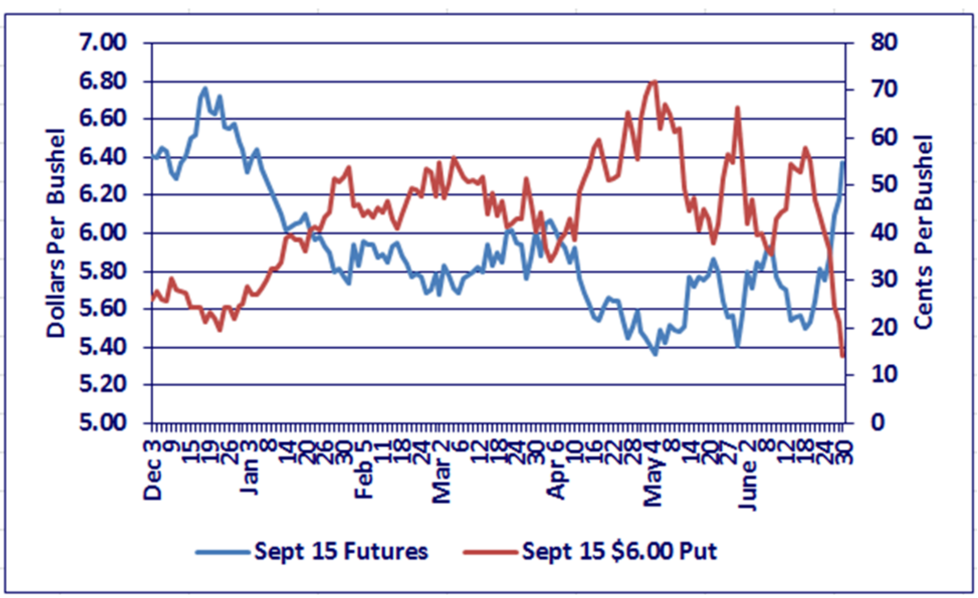
Spring wheat futures prices were highly volatile during the month of June. Contract prices decreased throughout much of 2015, and the September contract price settled at $5.58/bu on June 1. The contract then rallied somewhat during the first week of the month. But, futures prices closed lower throughout the rest of the month and reached a low of $5.50/bu on June 18. Then, prices increased sharply the last week of June. The September spring wheat futures contract settled June 30 at $6.37/bu -- a level not reached since January.

The recent rally in wheat prices has been a weather-driven, supply-side phenomenon. Excessive rain during the normal harvest period caused concerns about crop size and quality in the soft winter wheat growing areas of the eastern Grain Belt along the Ohio River. Just as the early U.S. wheat crop was being pounded by rain, other major wheat growing areas were suffering from a lack of precipitation. Western Canada and Northern Europe (two major world wheat exporting regions) continue to be hampered by drought. As we have discussed in previous newsletters, June and July are particularly critical periods for the world wheat crop and adverse weather can greatly influence prices.

As expected, the price of our September $6.00/bu strike put option responded to price movements in the underlying futures contract. The option's price was as high as $0.54675/bu on June 15 before reaching a low of $0.14375/bu on June 30. The purpose of purchasing the put option was to protect against national price declines below $6.00/bu. Since the current futures price ($6.37/bu) is $0.37/bu above our MGEX September put option strike price of $6.00/bu, our put option currently has no *intrinsic* value (i.e., if we were to exercise the option today, we would receive nothing from the option seller). The current value of the option is, therefore, its *time value* only and represents the market's evaluation of the probability that September wheat futures will fall below $6.00/bushel between now and September.

We have included a graph that presents the MGEX September 2015 futures price and the value of our $6.00/bu put option since our entry into the market. The correlation between the two price series continues to be almost perfectly negative (a correlation coefficient of -0.94) through the month of June. This means that our put option is a good hedge against changes in spring wheat futures prices -- declines in the futures market have been offset by gains in the value of our put option.

Graph 1: MGEX September Futures and $6.00 Put Option Activity



The expected September Great Falls Columbia Grain spring wheat basis declined substantially in June, but rallied as of late. The *wheatbasis.montana.edu* website forecasted the September 2015 basis for 14% protein spring wheat to be a **minus** $0.20/bu at the beginning of June, and as low as a minus $0.56 in late June. On June 30, however, the forecast is a minus $0.23/bu.

To discuss this further or if you have any questions you would like answered in the next newsletter, please contact Joe Janzen (, or 406-994-5616) or Gary Brester or 406-994-7883).

CONTACT INFORMATION:

Gary W. Brester

Department of Agricultural Economics and Economics
P.O. Box 172920
Bozeman, MT 59717-2920
Tel: (406) 994-7883
Fax: (406) 994-4838
Email: Dr. Brester
Location: 210B Linfield Hall

Gary Brester

George Haynes

Joe Janzen