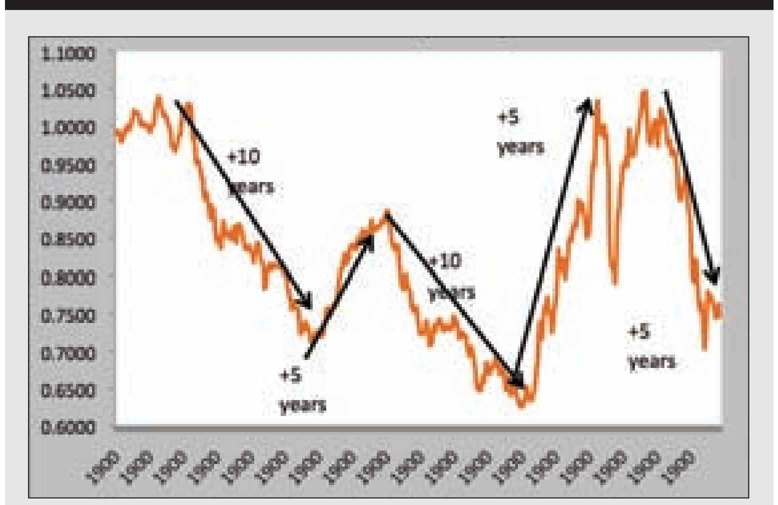
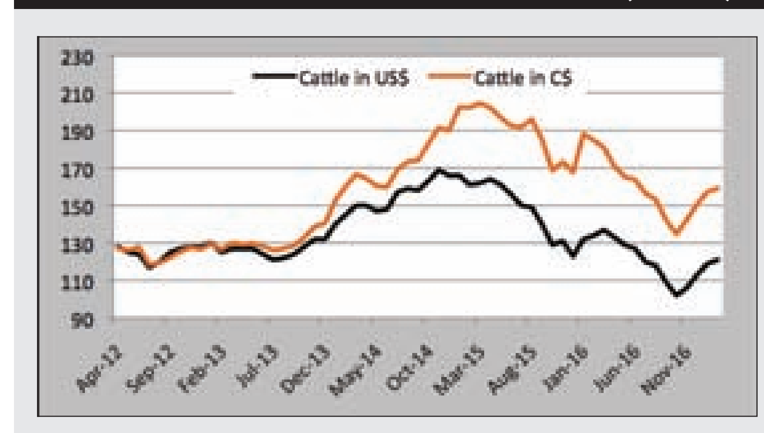
COLUMN

Separating your commodity and currency decisions

Currently fluctuations can be almost as significant as changing prices for your farm products

DAVID DERWIN
Hedging your bets





Since we live in Canada, while almost all commodities are traded around the world in U.S. dollars, the Canadian dollar/U.S. dollar exchange rate will have an impact on your farm revenues.

And since it directly or indirectly affects almost 100 per cent of your revenues, the Canadian dollar/U.S. dollar exchange rate can and should be a unique and separate farm marketing decision.

Long term, the Canada-U.S. interest rate differential has been the main driver determining the trajectory of the loonie. Historically, when the U.S. Federal Reserve begins down a path on interest rates, it usually continues in that direction for a period of time measured in many months, if not years. Furthermore, my *Farming Big Data* research study shows that from a technical chart point of view, the Canadian dollar often trends for periods between five and 10 years.

In March this year, the U.S. Federal Reserve raised interest rates for the third time in just a little over a year. With further U.S. rate increases likely going forward, this too suggests that the loonie will continue sideways to lower.

However, we know that a strong currency can have an impact on the farm. We can see the effects of a strong currency on U.S. farming. For instance:

- Chapter 12 farm bankruptcy filings in the top grain-producing states in the U.S. climbed last year.
- Indiana farmland values had dropped another 8.5 per cent after having fallen five per cent in 2015, according to the 2016 Purdue Farmland Value Survey.
- Cash rents are reported to have fallen across the Midwest.

These issues have not hit Canada, yet... and one of the reasons is a continued weak Canadian dollar.

So, since markets will go both up and down regardless of the longer-term fundamental situation, your farm marketing plan needs to be able to capture any weakness while still protecting against any strength, should it materialize.

It's in the basis

The Canadian dollar, among other pricing factors, shows up in your basis level. The basis difference is just the difference between your local cash bid and the associated futures contract price.

The currency component is embedded either implicitly or explicitly within the price for your commodity. Different companies express their basis level differently making things even more confusing at times.

So, make sure you understand both:

- How the basis is being quoted to you; and
- Your net cash bid or forward delivery price.

Once you understand how the basis component and how the currency affects the overall pricing, you can make marketing decisions based on both the price for your commodity and the price of the currency.

This is important since sometimes it will make sense to price just the commodity component but not the basis or the currency component. Other times it makes sense to take a flat all-in price. Sometimes it makes sense to take advantage of a good local basis but because the Canadian dollar is drifting lower, you want to capture any further currency weakness.

There are a lot of different pricing scenarios and Canadian dollar options and futures can help. They allow you to separate your currency pricing decision from your commodity component or basis marketing decision.

Currency versus commodity price movements

While Canadian dollar volatility is not as great as commodity price fluctuations, it is still an important source of opportunity and risk. For example, over the past 30 years, grain prices moved on average 14 per cent in any given six-month period, while cattle fluctuated about eight per cent. Meanwhile, the Canadian dollar change was about five per cent in any given six-month period. So, this five per cent currency movement is approximately a third of grain volatility and just over half of cattle; a significant volatility component to be sure.

AVERAGE SIX-MONTH FLUCTUATION

Cattle	8%
Grains	14%
C$	5%

To get a better sense of the impact of a weakening Canadian dollar, consider the cattle chart over the past couple of years, using price data from the University of Illinois and the St. Louis Federal Reserve, in both U.S. dollar and Canadian dollar.

Bottom line, farm businesses in Canada shouldn't expect a weak loonie to help meet profit targets, especially in these more challenging times. Likewise, be careful relying too much on grain or livestock forward pricing programs that require you to lock in the Canadian dollar. You are giving up the potential benefit of a weak Canadian dollar downtrend in this environment of gradually rising U.S. interest rates.

Sometimes you want to capture the currency weakness, other times you'll want to protect your revenues from a higher loonie. With a proactive approach to currency management using options and future strategies that trade on the Chicago Mercantile Exchange, you can separate the commodity and currency components of your farm revenues and be prepared for both.

David Derwin is a portfolio manager and commodity/investment adviser with PI Financial, which PI Financial Corp. is a member of the Canadian Investor Protection Fund. The risk of loss in trading commodity interests can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. This is intended for distribution in those jurisdictions where PI Financial Corp. is registered as an adviser or a dealer in securities and/or futures and options.

BRIEFS

New COO coming to Canadian Grain Commission

STAFF / Jocelyn Beaudette will be the next chief operating officer (COO) of the Canadian Grain Commission.

Beaudette will assume the role June 19, with current COO Gord Miles retiring at the end of June.

In her 26-year career with Agriculture and Agri-Food Canada, Beaudette has worked in marketing and trade, strategic policy and program delivery.

Her most recent role was as director general of the Farm Income Programs Directorate, delivering national programs at the regional level, including the recent Canadian Wheat Board Transition Costs Program.

Beaudette holds a master's degree in public administration from the University of Manitoba and an honours degree in political studies.

MPSG seeking member input

STAFF / Manitoba Pulse & Soybean Growers (MPSG) wants to take your pulse.

It's seeking the input of its membership through an online and print survey that's being administered by Insightrix Research.

"The pulse and soybean industry has seen a lot of change since MPSG conducted its last survey," says MPSG executive director Francois Labelle. "As an association, we want to make sure our priorities are meeting the needs of our growers, helping them make their farms and the industry they operate in as profitable and sustainable as possible."

MPSG last conducted a membership survey in 2013. Since that time, soybean acres have increased exponentially and, while pulse acres have been stable for the last five years, strong prices and a noticeable spike in interest among growers have put those crops in a position for growth, as well.

MPSG wants to use the information it will gather to shape its operations regarding issues such as research, management and communications.

MPSG wants to make sure it's researching the right things, saying the right things in the most effective mediums, and doing all of this in a responsible, well-governed way, the organization said in a news release.

Members can expect to find the paper survey in their mailboxes in the coming days, or they can fill it out online too, at www.manitobapulse.ca.