The art and science of farm marketing

There are no pat or easy answers for marketing commodities as each commodity is different

BY DAVID DERWIN
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Farm marketing like most aspects of a farm business is a mix of art and science, of theory and practice. And, it's important to understand and apply both. This reminds me of a quote by American playwright Wilson Mizner:

"Art is science made clear."

I'll try to combine them both so you gain a better awareness and appreciation of the power of exchange-traded option strategies for farm risk management.

My *Farming Big Data* research study shows that the numbers support options as a proven marketing tool. We know that options are an ideal marketing tool for producers with three unique advantages compared to a delivery or forward contract:

- No production commitments or delivery risk;
- Not locking in prices: downside price protection you need and the upside revenue potential you want;
- Minimal capital needed and minimal futures contract margin requirements.

Since a picture is worth a thousand words, the chart is what a revenue payoff using options looks like: potential upside price, revenue protection against the downside all without committing your commodity for delivery.

The revenue payoffs of option-based strategies speak for themselves, but what are other real-world benefits of option hedging applications?

Let's look at the current market to see why flexible option strategies are such a practical marketing tool for managing price uncertainty.

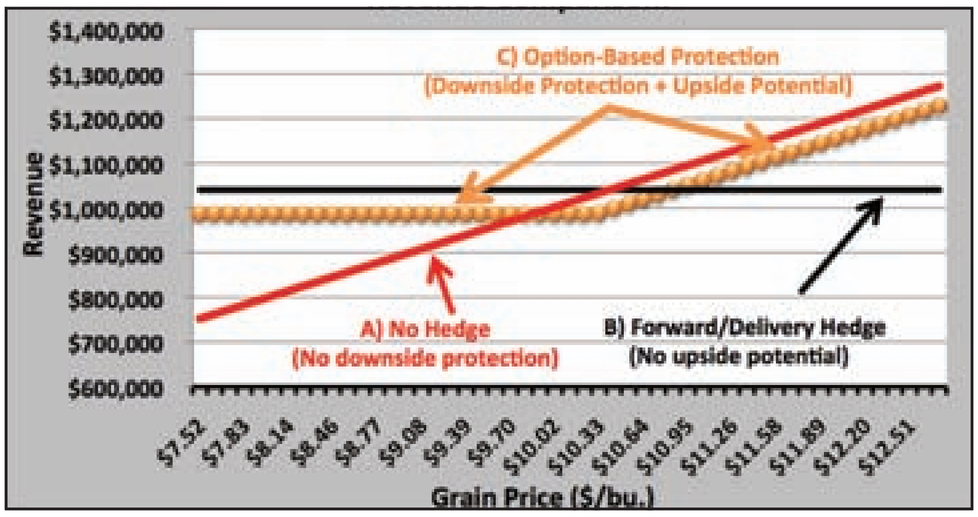
There are a lot of varying and conflicting factors that will affect your thinking and pricing decisions. Take canola for instance. Issues like strong crush demand, canola carry-out falling to the lowest level since 2013 and a weak loonie, down five per cent from the high this past winter, are all supportive of canola prices.

Some of the negatives include nearly 23 million seeded acres of canola, as well as large potential U.S. and South America soybean crops. Associated external price pressures include U.S. soybean futures down around 10 per cent from recent highs with palm oil prices 20 per cent lower since the beginning of the year.

And weather... always a mixed bag. For instance, while we've had a snowy and very wet spring in many parts of Alberta, just recently Accuweather was forecasting drought in central and northern Alberta.

All in all, a lot to analyze, research and think about.

REVENUE COMPARISON



Precision marketing

Just like precision ag is very data driven and field specific, farm marketing needs to be specific to each farm and commodity to address all the unique uncertainties for the crops you produce. Your marketing plan needs to be flexible enough to take into account current market price conditions, farm storage capacity and crop rotation, among other things.

There are many things you can do to fine-tune your marketing strategies to reduce risks but also give you the upside potential from rising prices. So don't just sell off the combine or use delivery contracts.

As we saw in last month's article, there are opportunities to separate your commodity and currency strategies when selling your grain or livestock.

You should differentiate between your basis and your future pricing decisions. Right now, new-crop canola futures are sitting above $500/ton but basis levels, according to www.PDQinfo.ca, are still in the negative $30 under range across the Prairies.

You can also look at what spreads between the various futures months are doing. Are there opportunities to store your grain and earn the carry? In some of the cereal markets like wheat and corn, the answer is yes. In oilseeds like canola and soybeans, since the futures forward curve is much flatter, the answer is no.

As for weather, options can help you manage that risk. If you don't want to sign a delivery contract when yields are uncertain in a very dry or very wet year, option-based strategies provide you with a delivery-free alternative.

These all factor in to the specific hedging and risk management strategies you develop for each commodity. What is best in one market is not necessarily the best in another. Different markets require different strategies. For example:

> *Let's look at the current market to see why flexible option strategies are such a practical marketing tool for managing price uncertainty.*

- A straightforward put strategy for canola works well given current conditions;
- A delivery contract for wheat may be the best approach, if you have a good basis;
- An option spread strategy may make the most sense for soybeans;
- Cattle has moved up significantly recently and is very volatile so dictates a different approach than just a month ago; and
- For the time being, you may not want to do anything on the Canadian dollar as it drifts lower.

Bottom line, with constantly changing chart patterns, uncertain supply-and-demand figures and ever-present summer weather risk, we don't know for sure where prices are headed. However, if you spend some more time on the art and science of marketing like you do on the theory and practice of growing your crop, you can reap bigger returns over the long term.

David Derwin is a portfolio manager and commodity/investment adviser with PI Financial Corp., 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.

Supply management not on NAFTA table

As Canada, the United States and Mexico move towards renegotiating the North American Free Trade Agreement, the federal government has reiterated its commitment to supply management.

"Our first interest in NAFTA, in any of our trade deal negotiations, is protecting the Canadian opportunities, so we've been very clear that we support supply management," Finance Minister Bill Morneau said during a recent stop at the University of Manitoba.

U.S. President Donald Trump has targeted Canadian dairy farmers in recent months, citing production north of the border as the reason why U.S. producers are swamped with excess milk. However, Morneau was clear that the supply management systems regulating the production of milk, poultry and eggs won't be on the table.

> *"We think that there are opportunities to improve NAFTA."*
>
> BILL MORNEAU

"As we move into discussions around NAFTA, we know that there will be important things to discuss," he said. "But we've been clear that supply management is something that we support and that will be how we go forward in NAFTA discussions."

Washington triggered a 90-day consultation period last month, a step required before the trade deal can be opened for renegotiation. — *Staff*