A Merchant’s Perspective

Rosalind Leeck
Demeter L.P.
July 8, 2008
First Trade: December 16, 2005 – 260
Last Trade: July 7, 2008 – 747 (limit down yesterday)
Low: January 9, 2006 - 260
High: June 27, 2008 - 796
First Trade: January 18, 2006 – 630
Last Trade: July 7, 2008 – 1561 (limit down yesterday)
Low: October 10, 2006 - 622
High: July 3, 2008 - 1635.5
MARGIN CALLS!!!!
The Merchants’ Three…or Four

• Financial Liquidity Challenges
• Futures Market Transparency
• Futures Market Performance
• Producer Default
Liquidity Challenges

Resulting from:

– volatility and higher prices

Resulting in:

– Operating Lines multiples of usual levels
  • Demeter – 6 times our typical line
– Reduction in grain buying/forward contracting
– Possible further consolidation in industry
Futures Market Transparency

• Know the participants

• Gauge the impact of the participants

• The bottom line is focusing on the speculative investment capital in the market and evaluating the impact
Futures Market Performance

• Serves very important functions
  – Risk management
  – Price discovery

• Convergence
  – Or at least basis predictability
Producer Default

• Very difficult to predict
• Extremely costly
  – Lifting hedges
  – Short grain
• No protection
Impact on Producers

• Wider than typical basis levels
• Reduction in forward contracting alternatives
  – Time
  – Type
• More questions by the merchants regarding your business
  – Percent sold
  – Crop conditions
  – Contingency plan
Conclusion

• The industry is experiencing a paradigm shift
• We will get through it
• There will be failures
• There are challenges
• There are opportunities
FARM POLICY STUDY
GROUP
TUESDAY, JULY 8, 2008
BECK AGRICULTURAL CENTER
Eugene L. Kunda, Ph.D.
Dec 2001- Dec 2005
\[ y = -0.87x - 0.61 \]
\[ R^2 = 0.87 \]

Mar 2006-Jul 2008
\[ y = -0.2956x + 2.0899 \]
\[ R^2 = 0.0901 \]

Note: September 2005 observations omitted
Chicago Soybeans

Basis (cents/bu.)

-100
-80
-60
-40
-20
0
20
40
60
80
100

Sep-01
Dec-01
Mar-02
Jun-02
Sep-02
Dec-02
Mar-03
Jun-03
Sep-03
Dec-03
Mar-04
Jun-04
Sep-04
Dec-04
Mar-05
Jun-05
Sep-05
Dec-05
Mar-06
Jun-06
Sep-06
Dec-06
Mar-07
Jun-07
Sep-07
Dec-07
Mar-08
Jun-08
Sep-08
Chicago Wheat Basis

Basis (cents/bu.)

FDD Chicago, Toledo, and St. Louis Wheat Convergence

Mar 2006-Jul 2008
\[ y = -0.1197x - 1.5648 \]
\[ R^2 = 0.0302 \]

Dec 2001-Dec 2005
\[ y = -0.76x + 2.5 \]
\[ R^2 = 0.48 \]

y = Change in Basis (cents/bu.)

x = Initial Basis (cents/bu.)
Total Short Commercial Open Interest in Grains
CME Corn, Soybeans, Wheat, KCBOT Wheat, MGEX Wheat

Millions

Jan-05  Mar-05  May-05  Jul-05  Sep-05  Nov-05  Jan-06  Mar-06  May-06  Jul-06  Sep-06  Nov-06  Jan-07  Mar-07  May-07  Jul-07  Sep-07  Nov-07  Jan-08  Mar-08  May-08  Jul-08
Margin Credit Swap Example

**Credit Provider-Speculator**
- Buys at $6.30 : Sells MCS at $6.30
- Margin collect of $.50 on futures margin payment of $.50 on MCS

**Elevator-Hedger**
- Buys at $6.50 : Sells MCS at $6.30
- Margin payment of $.50 on futures margin collect of $.50 on MCS

**Consumer**
- Buys at $6.50 and pays Elevator
- Elevator net gain $.30

**Elevator-Hedger**
- Buys at $6.50 : Sells MCS at $6.30
- $.20 loss on futures less interest on MCS

**Credit Provider-Speculator**
- Sells at $6.50 : Buys MCS at $6.30
- $.20 gain on futures plus interest on MCS

**Farmer**
- Forward sells at $6.00
- Delivers and is paid $6.00

<table>
<thead>
<tr>
<th>Day 1</th>
<th>Day 15</th>
<th>Day 30</th>
<th>Day 45</th>
<th>Day 60</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farmer</td>
<td>Elevator-Hedger</td>
<td>Credit Provider-Speculator</td>
<td>Consumer</td>
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</tr>
</tbody>
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Corn vs. Crude Oil

As of June 30, 08

$ per barrel

cents per bushel