Trader PhD

INTRO TO HEDGING

MANAGING PRICE RISK AND CAPITALIZING ON OPPORTUNITIES

TABLE OF CONTENTS

INTRODUCTION

There are many ways to manage risk in commodity markets. Those involved in buying and selling grain understand the potential price risks when marketing their commodities.

However, there are various tools that producers can use to manage those price risks. Hedging is a risk management strategy that involves taking the opposite position in the market until they have sold to protect profits or limit losses.

A farmer who sells his or her grain is considered to be long in the cash market and wants to get the highest possible price. When they want to hedge, they can take on a market position with a broker, using either futures or options, that will make money when the market moves opposite their cash position.

01

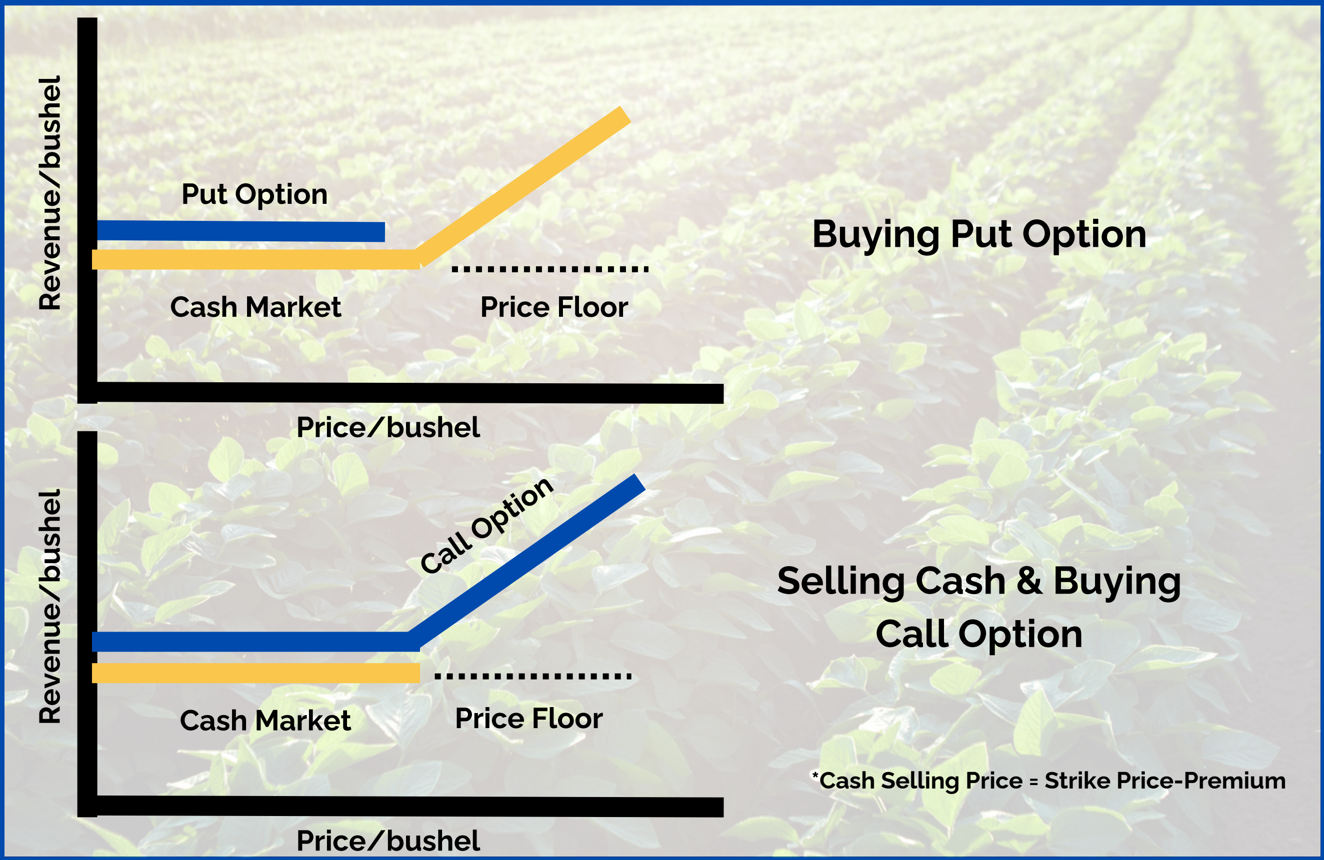
TYPES OF HEDGING STRATEGIES

Farmers and end users can enter a hedge in various ways. Most farmers hedge against downside risk by taking a bearish futures or options position with a commodity broker. Placing a hedge can involve various strategies using individual or a combination of approaches.

- Buying Put Options
- Selling Cash & Buying Call Options
- Selling Cash & Buying Futures
- Selling Futures

02 FOCUS ON THE UPSIDE

Hedging in the futures market involves creating a **price floor** for your grain to build on for the rest of the marketing year. A speculator willing to assume your downside risk lets you focus on the upside potential. Using options tends to have the most flexibility when attempting to capture additional upside compared to locking in a specific price with a futures hedge.



03

PROS & CONS

Like all marketing strategies, there are advantages and disadvantages.

Pros: Hedging using the futures and options markets can add price/profit production, help predict returns, and reduce stress. Hedging also offers flexibility and improved decision-making.

Cons: The downside of hedging is that prices could move against your position. Placing a hedge also involves upfront fees and capital. Certain hedges could also limit profit potential.

SUMMARY

Hedging is a profit management strategy that mitigates price risks. When you put on a commodity hedge with a futures broker, you are playing the market in a way that puts cash into your brokerage account when the market falls, therefore offsetting the paper losses you are taking on unsold bushels.

There is more than one way to hedge a commodity. Marketing strategies can look different between operations. Trader PhD's advisory service offers consultations to help optimize individual strategies that you can communicate with your broker.

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