Trader PhD
AG MARKETING

LEARNING THE BASICS ABOUT BASIS

TABLE OF CONTENTS

INTRODUCTION

Grain and livestock futures prices are important for understanding global supply and demand at a given time. Knowing the right time to buy or sell a commodity consists of understanding the market tone and watching seasonality. However, understanding local cash markets is critical for decision-making when marketing commodities.

That’s where the basis comes in.

WHAT IS BASIS?

The basis refers to the difference between the cash and futures price of a commodity.

Just as global supply and demand factors affect futures prices, local factors affect cash prices. The difference (basis) reflects the supply and demand in your local area. For example, did the crop come up short in your county or state? Or is there a lot of demand for ethanol, where a local processor wants to secure enough supplies to capitalize on higher margins?

For a merchandiser, the basis is what moves a commodity in and out of the marketplace. The bulk of grain basis movement happens in the first 45 days after harvest. Bushels have come to town, and elevators need to move (or store) them, ethanol/oilseed processors need to crush, and exporters need to ship them.

HOW IS BASIS SET?

Again, the basis communicates the relationship between supply and demand in the local cash market.

1

GEOLOCATION

BASIS CAN VARY IN DIFFERENT REGIONS AND LOCATIONS THROUGHOUT THE YEAR. BASIS CAN VARY BASED ON THE AMOUNT OF GRAIN PRODUCTION IN A LOCATION, AS WELL AS ITS USE FOR LIVESTOCK FEED, PROCESSING, AND ETHANOL PRODUCTION.

2

TRANSPORTATION COSTS

TRANSPORTATION COSTS COME INTO PLAY, ESPECIALLY FOR GRAIN ELEVATORS.

3

STORAGE COSTS

STORAGE COSTS CAN PLAY A FACTOR. IN A NORMAL YEAR, CORN AND SOYBEAN PRICES TEND TO BE THE LOWEST AT HARVEST AND INCREASE BY SUMMER IN THE FOLLOWING YEAR. AS SUMMER APPROACHES, STORAGE COSTS TEND TO DECREASE, AND BASIS NARROWS.

4

SUPPLY & DEMAND

SUPPLY AND DEMAND HAS THE ULTIMATE SAY IN BASIS - AGAIN, THAT IS LOCAL S&D. IF AN ETHANOL PLANT IS RUNNING SHORT ON CORN BUSHELS, IT MAY RAISE ITS BASIS TO INCENTIVIZE FARMERS TO DELIVER SUPPLIES TO THE PLANT.

SPREADS

Grain merchandisers also utilize spreads to manage their basis. Every change in the spread is the market's way of managing the long-term balance of supply and demand. Spreads are the force that ration the total supply from one crop year to the next.

Futures spreads describe the current situation of supply and demand balances or imbalances. For example, in the corn market, if the spread between the March '25 and May '25 contracts is negative, there is carry in the market. If the spread is positive, the market is inverted and is signaling that there is strong demand for corn relative to available supplies.

A merchandiser looks at futures spreads when setting basis because it impacts their margin and storage decisions. If carry exists, they might offer a weaker nearby basis (to encourage later delivery) and try to capture the spread by buying nearby grain and selling deferred futures. If the market is inverted, they might offer a stronger nearby basis to pull grain in now, since holding it could result in a lower futures price later.

HOW BASIS RELATES TO YOUR OPERATION

Basis becomes important for producers and hedgers when deciding whether to place a hedge or lift a hedge.

If a producer wishes to lock in a specific futures price, they can do so by selling a futures contract for the period they wish to deliver in. For example, in March, a producer can lock in the futures price of a commodity, specifically corn, for the upcoming harvest by selling a December futures contract. By selling December futures, they lock in their gross sale price.

However, by going short the futures, the producer is now long the basis, meaning that they want the basis to appreciate between when they entered the hedge and when they plan to exit the hedge and deliver the grain. This can also be done by using a "hedge-to-arrive contract" with a local elevator.

Meanwhile, a "basis contract" can also be used to lock in the basis, but it keeps the final price open depending on the changes in the futures market. Understanding your local cash market is important for identifying whether hedging with the futures market or entering a basis contract may be more appropriate.

SUMMARY

Understanding basis is key to effective grain marketing. While futures prices reflect global supply and demand, basis reveals what's happening in your local market. By monitoring basis, producers can make more informed decisions about when and where to sell grain, how to hedge effectively, and how to manage storage and transportation. Whether locking in futures prices or targeting favorable basis levels, a clear grasp of local market dynamics can make the difference in capturing the best margins

Trader PhD
AG MARKETING

CONTACT US

(515) 999-5522

www.traderphd.com
info@traderphd.com

4800 Westown Parkway, Suite 320
West Des Moines, IA 50266