



Use caution when trading in the coming year

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Merchandising grain involves risk. Merchandising in the face of potential terrorist actions poses unusual risk. But what should you prepare for? Could terrorists blow up the Panama Canal, or maybe a financial catastrophe develops?

Positioning for the unthinkable isn't impossible, but it does mean thinking how such events would affect your ability to stay afloat. Take the issue seriously — the waves could be especially big this year.

When the grain embargo was implemented in 1980, for example, basis plummeted

and carries widened immediately. Firms that were long basis with no ability to stay the course took sizable losses liquidating their positions. Firms with space and money found themselves positioned to make substantial merchandising profits that year.

Look ahead and remember the past

As you evaluate alternatives this year, challenge your assumptions and expectations and remember September 11th. Factor uncertainty into your grain trading decisions because there's no way to know where or when the next crisis will develop. You can't control terrorists, and you can't quantify the

reactions, but you can manage risks that are closer to home: basis risk, price risk, spread risk, contract performance risk, financial and credit-line risk, logistics and quality risk.

Scaling back your limit for these risks is one conservative approach for unsettled times. Today's situation can change in a heartbeat. If you would normally carry 1 million bushels of long corn basis into spring/summer, consider forward selling part of that and cutting your basis risk to 400,000 to 500,000 bushels, maybe less. If you have a basis offer in front of a buyer, but you're still 1 cent apart, think seriously about how long you want to risk waiting for that last penny.

Erring on the conservative side

The conservative approach for futures is to use them to reduce price risk, not to try to outguess the market, especially this year. Selling futures as soon as you buy grain and pricing sales by exchanging futures are conservative strategies. Covering short-term input needs by buying futures is reasonably low risk, but covering feed or ingredient needs for the entire year is high risk this year, unless you're also forward-selling corn flakes, cattle or other products.

Use futures spreads to your advantage when opportunities arise. Carries bring income to your operation; empty space earns nothing. Right now the market pays to hold as much corn as you can for as long as you can — even into 2002 crop. That provides a hedge against the chance of empty space next harvest. But limit your overall trading and logistics risk by selling parts of your position for forward time slots, and carefully limiting how much net basis exposure you will accept. This defines your trading position, clarifies your logistics and allows you to show a lender how you will repay loans.

Place short hedges forward when carries exceed your costs. Locking in a corn

futures carry at 70% of full carry instead of aiming for 80% doesn't make you a bad trader, and it doesn't mean you have to hold your position long-term. But it will protect you if you choose to hold the inventory, or if logistics or a basis collapse force you to wait.

Carrying company-owned wheat no longer offers long-term profits as it has for several years. The time has come to empty those bins of hedged wheat inventories and use the space for corn if possible. That looks like a much lower risk position this year.

The wave you don't see coming

Basis and spreads aren't necessarily the biggest risks merchandisers will face. Risk management departments of banks, insurance firms, brokerage firms and the like are assuredly analyzing their exposure these days. These departments will be scrutinizing their firms' customers and contracts with an eye to the unpredictable. Think how others would assess your company — you may pose an unacceptably large risk to someone else! Sophisticated software lets firms run "what if" scenarios to identify the financial impact of events — routine or extreme. Risk management departments typically report directly to the CEO or president, and their recommendations are heard quickly.

Banks will be quicker to call loans, refuse credit or demand tougher terms in uncertain times. Lenders may increase documentation and monitoring, or even trim off their riskiest clients.

(Although unrelated to terrorist activities, the recent failure of several grain elevator operations is sure to raise red flags to ag lenders, insurers and regulators.)

Brokerage firms will be quicker to liquidate positions against unmet margin calls, or to raise margin rates above the minimum requirements. Insurance companies may refuse to renew coverage.

Elevators and other small businesses may be completely unaware that such scrutiny and change is occurring — until decisions are made. Talk frequently with your lenders, respect your loan covenants, be sure all reports are accurate and on time, and meet your margin calls or loan payment dates promptly.

Provide current, detailed, accurate financial statements with all positions correctly marked to the market. Maintain a complete Daily Position Report showing all merchandising risk positions. Lenders don't like surprises, especially this year.

Containing contract risk


Watch your customers for signals that they may pose potential contract risk. Slow payments by buyers, phone calls that aren't returned, and similar signs should trigger immediate scrutiny. Don't let someone else's problems become your problems.

Rail shippers can reduce credit risk. First, spread sales across several firms to limit your receivables-risk on unsettled contracts.

Secondly, ship on Order Notify bills of lading. Proceed cautiously with any buyer that says "an Order bill of lading isn't necessary; we're sound" or beware that Order bills of lading are "too much work."

Some shippers refuse to sell to any firm that won't accept Order bills. It may limit the seller's markets, but it definitely limits the seller's financial exposure!

Always look at the bright side

The new year already offers good opportunities. The crops are big, interest rates and prices are low and the biggest crop — corn — offers generous carries. Taking business precautions doesn't mean having to pass up opportunities. But a healthy dose of skepticism and caution might just save your business this year. 

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