CROP MARKETING STRATEGIES

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2006 Dead Cat Bounce

The term "Dead Cat Bounce" is an old reference to the performance on the New York Stock Exchange. For no apparent reason, a market moves higher. The name was affectionately given to the performance each fall of the soybean market by Roy Smith, farmer and market advisor from Plattsmouth, Nebraska.

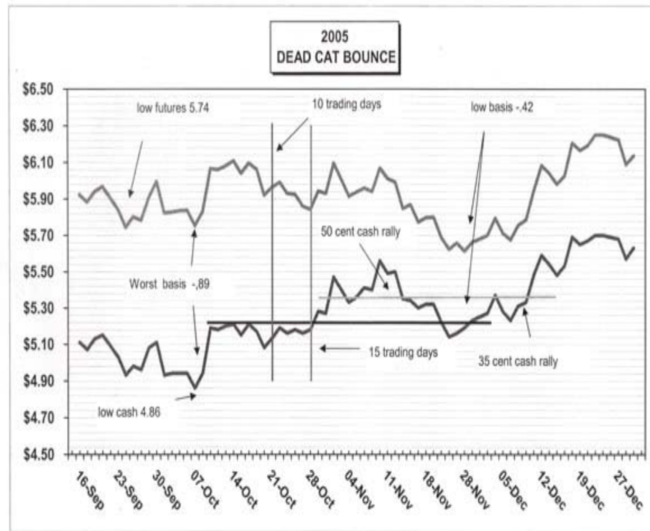
Smith charts the January soybean futures contract along with his local cash price. The different lines in the graphs that follow reflect a SE Nebraska basis. It features the January contract as the top line since the November contract will soon expire. Once a harvest low cash price is reached, he counts 10 consecutive trading days that the price is higher than this low cash price.

Once the Dead Cat Bounce is confirmed, expect at least a 35 cent/bu. cash price improvement to occur, but most years that price is 50 to 60 cents/bu. higher. This increase in cash price will usually reflect at least 15 cent/bu. basis improvement and the balance from the higher January soybean futures price.

The 2005 Dead Cat Bounce

Reviewing 2005 performance, the lowest cash price in SE Nebraska occurred in early October at $4.86/bu. The basis was abnormally wide at 89 cents/bu., largely due to Hurricane Katrina and the lack of export sales.

Counting 10 trading days, the Dead Cat Bounce was confirmed by late October. By mid-November, a 50 cent/bu price improvement over the harvest low was noted. A decision would then be made by a producer as to the level of soybeans sales. In many cases, soybeans being stored commercially could be priced to avoid the 4 to 6 cents/bu./month storage and interest charges.



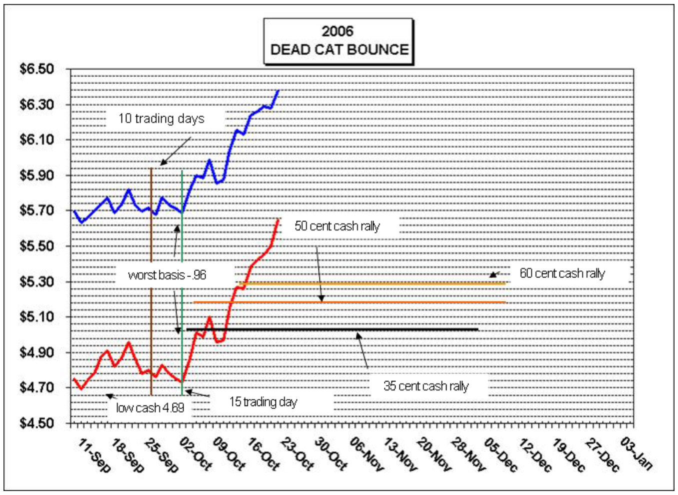
Tracking Performance

According to Smith, the Dead Cat Bounce has occurred every fall since 1980. The normal harvest cash price low is around October 4^{th}. The harvest rally of at least 35 cents/bu. usually occurs between this time frame and mid-November, but in some years can last into late December. Over this 27 year period, it is rare for the Dead Cat Bounce to be more than a dollar a bushel.

Even the most recent bull market following the 2003 U.S. soybean harvest saw only a $1/bu. price improvement from the harvest low to mid-November. The rally in cash price to $10/bu. cash price at some Midwest processors did not occur until the following spring and summer as problems with the South American soybean production was realized.

The 2006 Dead Cat Bounce

Larger U.S. soybean ending stocks, increased planted acres, and good August growing conditions pressured cash prices lower prior to harvest. The harvest low appeared early this year, occurring on September 12th at $4.69/bu. The minimum of 10 trading days after this low was confirmed on September 25th.



The minimum rally of 35 cent/bu. was realized by early October. The 50 to 60 cent/bu. cash price improvement occurred by mid-October. At this writing in late October, the cash price had already improved over $1/bu. from the harvest cash price low and all objectives of the Dead Cat Bounce were met in 2006. This result could vary by geographic location, since some elevators and co-ops still have wider than normal basis for this time of year.

Conclusions

An individual producer will need to determine if and how to use the Dead Cat Bounce phenomena described. It does have a proven record of performance, but nothing in the market is certain. Recently, extreme futures price volatility has been heavily influenced by the role of commodity funds, and the emergence of soybean oil as a biofuel.

Pricing a portion of commercially stored soybeans makes sense, especially for farms managing cash flow and debt. With larger than expected 2006 soybean yields in many locations across Iowa, the additional $1/bu. price improvement and extra harvested bushels should provide for a profitable year on many farms.

Soybeans being stored on-farm will likely have a much lower cost of ownership. Those soybeans might be taken "under loan" at a pre-established county loan rate. Interest will accrue at a rate slightly above 6% APR for up to 9 months. This allows more pricing flexibility over a longer period of time.

For those that see the opportunity to sell cash bushels now or in the near future, but still want to participate in a futures price rally, futures options make sense. One can reown those soybean bushels sold by purchasing a soybean call option. An "at-the-money" May call option currently carries a premium of about 40 cents/bu. Compare this cost to the commercial storage costs alone for 6 months (October through April) of around 30 cents/bu.

Should futures prices rally prior to the cash sale, the premium for the "at-the-money" May call option will increase with the futures price and reflect both time value of this option and price volatility. If a cash sale is made and the futures price then declines, the call option premium will decline, but not penny for penny since time value will remain. This May call option will not expire until the 3rd week of April, 2007, allowing time to reflect uncertainty of production in South America as well as early planting indications in the U.S.

Consult with your commodity broker about specific questions that you might have about the use of futures and options contracts.

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