Futures Hedging and Basis Movement

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Futures Hedging

- Hedging: taking an equal and opposite position in the futures market than you have in the cash market.
- A farmer hedges by taking an action now in the futures market that they will take later in the cash market.

Basis

IOWA COMMODITY CHALLENGE

- The difference between the cash price and futures price. Many factors influence basis: local supply/demand, etc.

- The calculation for basis is:

Cash Price	–	Futures Price	=	Basis
$3.10	–	$3.55	=	- 45¢
$9.00	–	$9.60	=	- 60¢

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Basis

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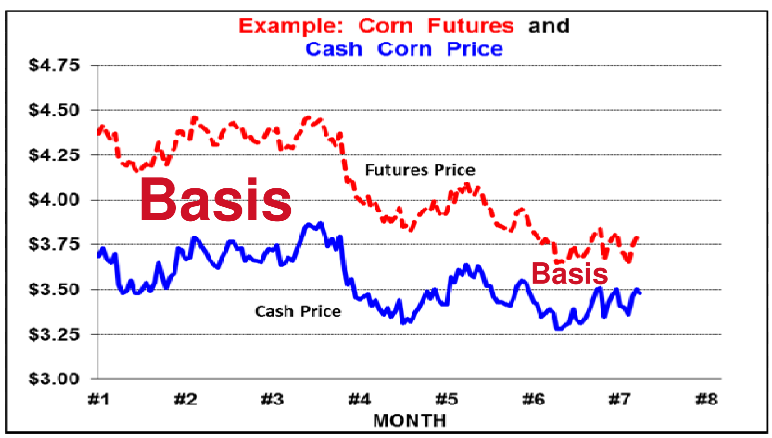
The difference between the local cash price and the underlying futures price of a commodity.



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Example futures hedge story

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- It's November: goal is to sell 5000 bu. of cash corn in late Feb. at $3.70.
- Estimated basis for late February is -30¢ (cash under March futures).
- March corn futures are sold at $4.00.
- **What happens if basis is different than expected?**

**Hedging examples do not include commissions and interest.*

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Hedging Example (market lower)

IOWA COMMODITY CHALLENGE

DATE	CASH	FUTURES	BASIS
November	Goal: $3.70 Cash Corn	Sell 1 March Corn @ $4.00	Estimated: - 30¢
Late February	Sell Cash Corn @ $3.40	Buy 1 March Corn @ $3.50	Actual: - 10¢
Results	- 30¢	+ 50¢	+ 20¢

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Hedging Example (market lower)

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Results	- 30¢	+ 50¢	+ 20¢

Net Hedge (without commissions and interest cost)

1. Original futures less actual basis = net hedge
   $4.00 – 0.10 = $3.90
2. Cash sale to buyer +/– futures gain/loss = net hedge
   $3.40 + 0.50 = $3.90

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Hedging Example (market higher)

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Hedging Example (market higher)

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Key points:

Futures Hedging and Basis Movement

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- A Hedge-To-Arrive (HTA) cash contract is similar to futures contract hedging.

- Basis is key to result of futures sold hedge or HTA:
  stronger basis than expected = higher price
  weaker basis than expected = lower price

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