

RIGHT RISK NEWS

Managing Cattle Market Risk

DATES TO REMEMBER

Spring crop acreage reporting deadline
- July 15

Margin Protection Program Dairy (MPP-D)
- 2017 crop year
July 15th-Sept. 30th

Forage Insurance
- September 30th

RI-PRF Coverage
November 15th, 2016 for 2017 crop year coverage

Acreage Reporting:
- November 15th

For more information see:
<http://www.rma.usda.gov>
<http://www.fsa.usda.gov>

Calves are on the ground and cattle are headed out to pasture. Hopefully, spring calving season has gone well and the grass is greening up nicely as you look forward to a good production season.

Unfortunately, cattle markets have declined over the last several months and protecting profits has become a bit more challenging in the current market environment. As discussed in past issues of this newsletter (*October 2015*), maintaining and updating a marketing plan brings discipline to the marketing process that is often rewarded in times like these. Most importantly, it helps to think through realistic marketing goals and consistent strategies to increase the likelihood of success.

What does success look like in a marketing plan? We generally judge success in a marketing plan based upon what could have been: *the price actually received versus the price that we could have received if we had done things differently.*



Rarely do our decisions lead to receiving the absolutely best price possible, so we are often left with feelings of regret. However, this measure is not fair. We should judge success based upon how well our marketing plan helped us to achieve our marketing goals. In addition, when it comes to managing risk, our marketing goals should be more than just getting the highest price possible.

In a downward trending market, what are some goals we might set for our marketing plan? Current Chicago Mercantile Exchange (CME) futures prices for October feeder cattle are just under \$140 per hundred-weight (cwt). This is about a \$20 per cwt lower than it was six weeks ago. Historically, how accurate are early summer forecasts for October feeder cattle prices. Table 1 would suggest “not very.”

The current CME Feeder Cattle cash settlement index is around \$143 per cwt. If that also turned out to be the settlement price at the end of October, it would be a little over \$3 higher than the current futures price contract for October. This would be right in line with the four year average we see in Table 1 but, as we also see in Table 1, it would also be the first time in the last five years that any one year has been close to that average. Markets are risky and uncertain, which is why we need a plan to address it.

	2012	2013	2014	2015	Average
CME Oct Feeder Cattle Futures (on date)	161 (Jun 5)	149.23 (Jun 4)	200.52 (Jun 5)	219.1 (Jun 5)	182.46
CME Feeder Cattle Cash Settlement Index	144.94 (Oct 30)	165.24 (Oct 29)	239.95 (Oct 30)	193.24 (Oct 30)	185.84
Net Change	(\$16.06)	\$16.01	\$39.43	(\$25.86)	3.38

Source: Livestock Marketing Information Center (LMIC)

At the time we draft this article, we are in a relatively down market compared to the last few years. Inventories are up 3-7 percent depending upon which segment of the market you are looking at and supply-chain supply is outstripping demand, given current sales of retail beef.

Most of this information is already priced into the market place. Marketing plans should remain concerned with limiting potential downside risk but they should also leave open the possibility of benefitting from potential upside movements in the market. Put options and Livestock Risk Protection (LRP) insurance contracts are two tools that could be used to implement marketing plans with these objectives.

How Much Risk is Right for You?

HIGHLIGHTED TOOL

Continuing changes in commodity markets requires constant adjustment on the part of today's risk managers. The *Risk Scenario Planning* tool is designed to help managers evaluate an uncertain future by thinking in terms of distributions, instead of trying to come up with a best guess for an uncertain number.

The tool relies on a partial-budget framework to capture the financial effects of making proposed changes. It then allows the decision-maker to further refine estimates for up to two input values as uncertain numbers.

This produces a more robust analysis of the proposed change and a more thorough understanding of the possible outcomes if one or more changes are implemented.

To access the tool or to read the accompanying guide see: <http://RightRisk.org> > Resources > Risk Management Tools.



MANAGING CATTLE MARKET RISK CONTINUED FROM PG. 1

Table 2 shows how LRP Feeder Cattle insurance contracts would have performed for Steers Weight 1 from 2012-2015. In this example, 86 percent of the upward price movement in the good years of 2013 and 2014 is captured in the bottom line after subtracting off the LRP premium payment. Meanwhile, less than 35 percent of the downward price movement in the bad years of 2012 and 2015 are captured in the bottom line after adding in the net LRP effect.

Knowing our production costs and cash flow needs are important components of determining our need for downside price risk protection. Understanding market conditions and knowing the right tools to use will help us reach our marketing goals.

	2012	2013	2014	2015	Average
LRP 21-week Coverage Price (on date)	166.33 (Jun 5)	160.59 (Jun 4)	220 (Jun 5)	238.95 (Jun 5)	196.47
LRP Expected Ending Value (Date)	177.414 (Oct 30)	164.142 (Oct 29)	220.578 (Oct 30)	240.871 (Oct 30)	200.75
LRP Actual Ending Value (Date)	159.43 (Oct 30)	181.76 (Oct 29)	263.95 (Oct 30)	212.56 (Oct 30)	204.43
Net Change	(\$17.98)	\$17.62	\$43.37	(\$28.31)	\$3.67
LRP Indemnity	6.90	0.00	0.00	26.39	8.32
LRP Producer Premium	1.97	3.26	5.22	1.04	2.87
Net LRP Effect	4.93	(3.26)	(5.22)	25.35	5.45
Net Effective Price	\$164.36	\$178.50	\$258.73	\$237.91	209.88
Deviation from Expected Ending Value	(\$13.05)	\$14.36	\$38.15	(\$2.96)	\$9.12

Source: http://www3.rma.usda.gov/apps/livestock_reports/

Readers interested in learning more about using LRP insurance are encouraged to reread our March 2014 edition of *RightRisk News* and access our LRP Insurance Example decision for the *Risk Scenario Planning* tool on the RightRisk Tools page at RightRisk.org. There are also numerous fact

sheets available on Livestock Risk Protection for Feeder Cattle at various other online sources, just Google "LRP price protection" to locate.



RightRisk helps decision-makers discover innovative and effective risk management solutions.

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How much risk is right for you and your operation?



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EXTENSION

