



## ***Cattle Pricing and Risk Management***

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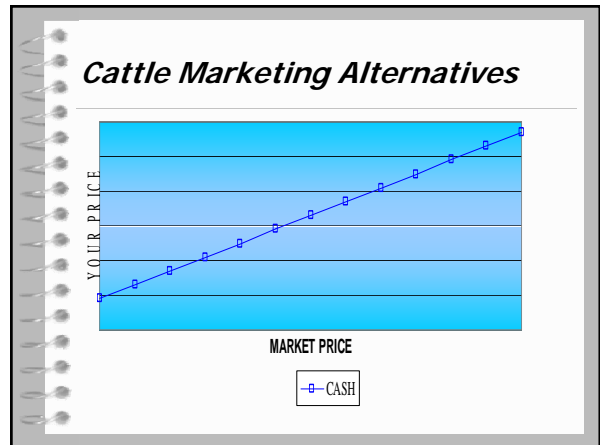



### ***Pricing Considerations***

- ☐ Risk
- ☐ Market Outlook
- ☐ Profit Target or Breakeven

### ***Evaluating Pricing Alternatives***

- ☐ Cash
  - High risk/highest return potential
  - Bullish market outlook



### ***Basic Pricing Alternatives***

- ☐ Cash
- ☐ Short Hedge
- ☐ Put Options
  - At-the-money
  - Out-of-the-money
- ☐ Synthetic Put
- ☐ Fence

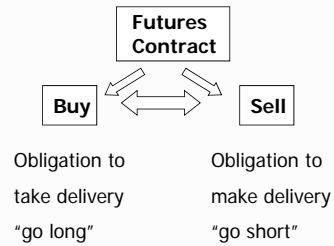
### **Risk Management with Futures/Options**

- ☐ Combining a futures market position with a cash market position to reduce risk
- ☐ Risk management is costly and is a cost of doing business
- ☐ Each producer has different risk management needs

## A Futures Contract

- ☐ A commitment to make or take delivery of a given commodity at some time in the future

## Futures Market



## Feeder Cattle Futures

- ☐ Contract Size: 50,000 lbs
- ☐ 650-849 lb. Med/Large #1 Steers
- ☐ Cash Settled to CME Feeder Cattle Index
- ☐ Contract months: JAN, MAR, APR, MAY, AUG, SEP, OCT, NOV
- ☐ Daily Trading Limit: \$3.00/cwt.

## Matching Contract Size

- ☐ 1 Feeder Cattle Futures Contract equals:
  - 67 head of 750 pound steers
  - 77 head of 650 pound steers
  - 111 head of 450 pounds steers

## *General Futures/Options Considerations*

- ☐ Effectiveness of both depends on basis
- ☐ Futures
  - **Simple and cheap**
  - **Establish fixed prices**
  - **Margin calls**

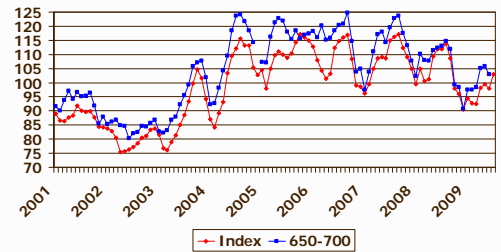
## Basis

- ☐ Basis: The difference between two prices.
  - The relationship between local cash and the futures price
- ☐ Basis = Cash Price - Futures Price
- ☐ Feeder Basis = Cash Price - CME Feeder Index

## Factors Affecting Livestock Basis

- ☐ Location
- ☐ Season
- ☐ Animal weight
- ☐ Animal quality
- ☐ Animal gender

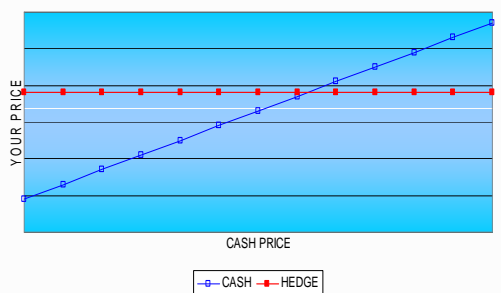
## Feeder Futures Index and 650-700 lb. Steer Price, OKC



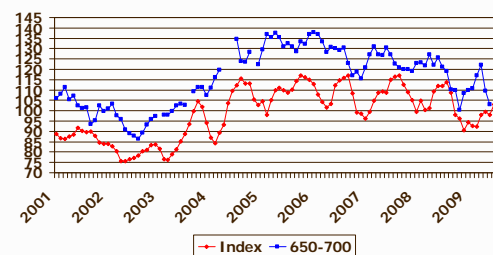
## Oklahoma City Steer Basis \$/cwt. (Avg. 2004-2008)

MONTH	450	550	MONTH	450	550
JAN	28.52	16.16	JUL	23.20	13.48
FEB	33.81	22.30	AUG	20.47	12.30
MAR	34.83	24.51	SEP	20.22	10.54
APR	32.66	22.64	OCT	21.21	9.20
MAY	27.80	19.45	NOV	26.96	14.51
JUN	24.45	15.26	DEC	26.96	14.15

## Cattle Marketing Alternatives

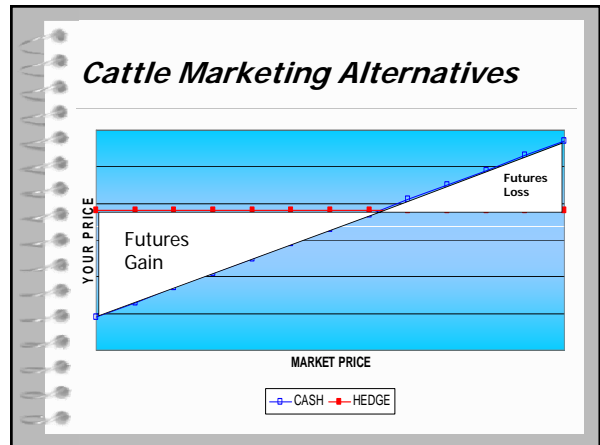
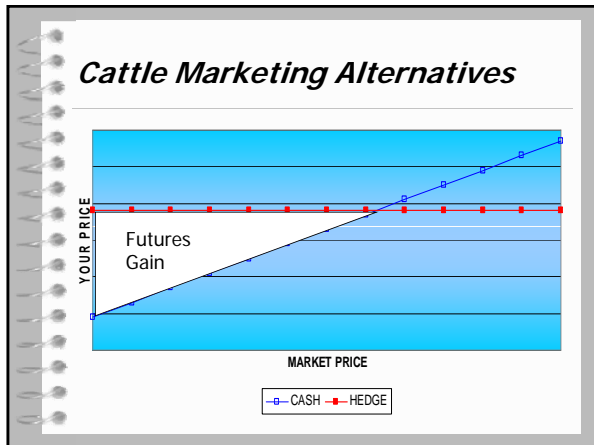
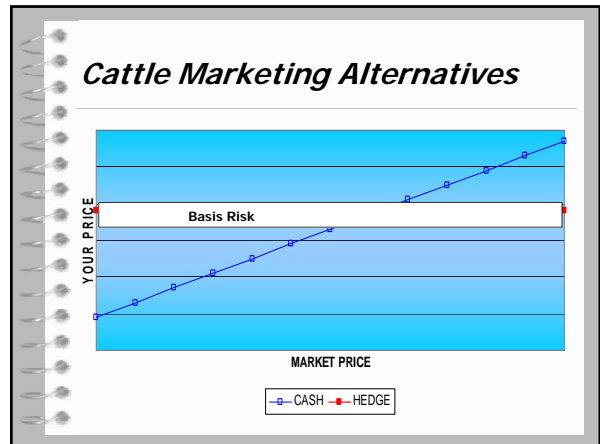
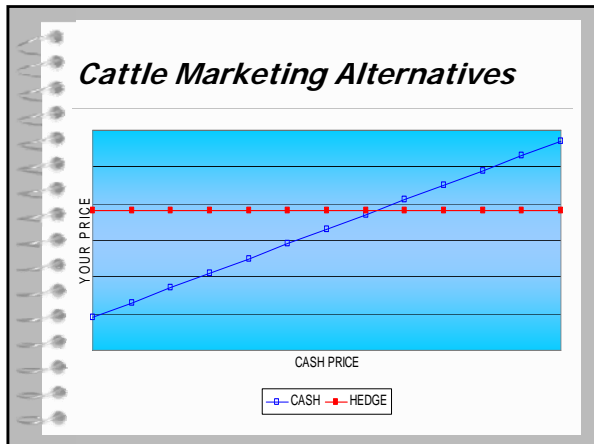


## Feeder Futures Index and 500-550 lb. Steer Price, OKC



## Med/Large Frame #1 Steer Basis, OKC

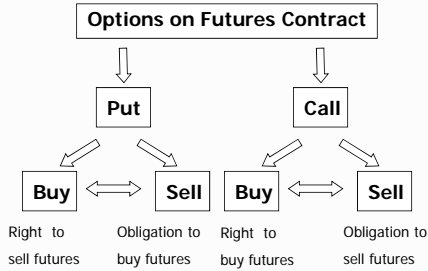
- ☐ 400-500 lb. Steers NOV
  - Avg (2004-2008) 26.96
  - Max (2005,2006) 31.81
  - Min (2008) 16.35
- ☐ 500-600 lb. Steers NOV
  - Avg (2004-2008) 14.51
  - Max (2004) 19.33
  - Min (2007) 9.22



- ### Evaluating Pricing Alternatives
- ☐ Cash
    - High risk/highest return potential
    - Bullish market outlook
  - ☐ Short Hedge
    - Risk limited to basis risk
    - Highest minimum price coverage
    - Similar to forward cash contract
    - Bearish market outlook

- ### General Futures/Options Considerations
- ☐ Effectiveness of both depends on basis
  - ☐ Futures
    - Simple and cheap
    - Establish fixed prices
    - Margin calls
  - ☐ Options
    - Protect downside
    - Maintain upside potential
    - More costly than futures
    - no margin calls
    - time limitations

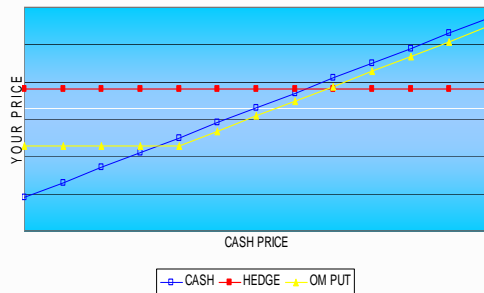
## Options Market



## Evaluating Pricing Alternatives

- ☞ Out-Of-The-Money Put Options
  - Less costly
  - Provide disaster coverage for major wrecks
  - Slightly bearish to moderately bullish
- ☞ At-The-Money Put Options
  - Most costly
  - Moderate breakeven/profit coverage
  - Moderate/highly bearish, limited price declines

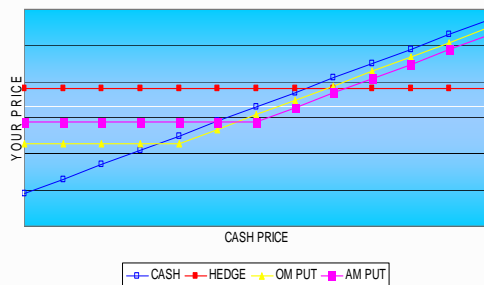
## Cattle Marketing Alternatives



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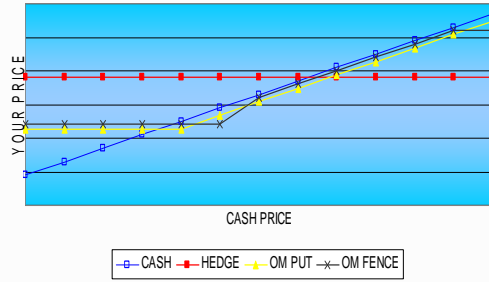
## Cattle Marketing Alternatives



## Evaluating Pricing Alternatives

- ☞ Synthetic Put (Short Hedge + Buy Call)
  - Relatively costly
  - Allow "Plan B" change in plans or outlook
  - Maintain minimum price
- ☞ Fence (Buy Put + Sell Call)
  - Cheapen put option cost
  - Use with probable trading range
  - Slightly bullish/bearish, limited upside

## Cattle Marketing Alternatives



## Other Considerations

- More Complex Futures/Options Strategies
- Cash Marketing Risk Management
- Cash Forward Contracting

