

Name: _____

Econ 337 Agricultural Marketing, Spring 2018

Homework Assignment 2; Due February 8, 2018 (Beginning of Class)

1) A summer backgrounder operator decided to hedge 750 pound feeder steers to be sold in October. He/she sold October futures at \$142.225 per cwt and expected basis to be \$7.960 per cwt for the quality of steers they will be selling. Assume brokerage commission is \$60/round turn or \$0.150 per cwt.

a) What price does the backgrounder think they have locked in for these steers come October?

Parts b and c are stand alone questions using this same initial position from question 1.

b) In October, the backgrounder sells the steers for \$164.975 per cwt and closes his/her futures contract at a price of \$153.090 per cwt.

-what is the gain/loss on the futures position?

-what did basis turn out to be?

-what is the net selling price on the calves?

-Is the expected selling price equal to the net selling price? If yes, why? If not, why not?

c) Forget part b! In October, the backgrounder sells the steers for \$156.765 per cwt and closes his/her futures contract at a price of \$149.675 per cwt.

-what is the gain / loss on the futures position?

-what did basis turn out to be?

-what is the net price on the calves?

-Is the expected selling price equal to the net selling price? If yes, why? If not, why not?

2) Go back to the scenario set up in problem #1. A summer stocker operator decided to protect cattle to be sold in October. October futures are trading at \$142.225 per cwt and basis is expected to be \$7.960 per cwt for the quality of steers they will be selling. However, instead of a straight hedge, the backgrounder decided to purchase a put option with a \$135 strike price for \$4.900 per cwt. Assume brokerage commission is \$30 (\$0.075/cwt) to buy an option contract and \$30 (\$0.075/cwt) to sell offset a futures position.

a) What price floor does the backgrounder think they have set?

Parts b and c are stand alone questions using this same initial position from question 2.

b) In October, the backgrounder sells the steers for \$155.765 per cwt. The futures price has risen to \$147.805 per cwt. Does the backgrounder want to excise his/her option?

-What will be the net price for the calves?

c) In October, the backgrounder sells the steers for \$137.960 per cwt. The futures price has fallen to \$130.000 per cwt. Does the backgrounder want to excise his/her option?

-What will be the net price for the calves?

3. This question is designed to give you some practice using spreadsheets and estimating basis for feeder cattle. Use the “CombinedAuctionIA-Feeder Cattle Cash Prices” and “Feeder Futures Prices” spreadsheets to estimate basis for each month and each year for feeder cattle. Calculate the 5-year average basis by month. Using a spreadsheet will be much quicker than doing this by hand.

Write your basis estimates into the table below, or attached a print out of the table.

Combined Iowa auction feeder cattle basis, 2013-2017 for 700-800 lb no. 1 steers (\$/cwt)							
Market Period	Contract For Basis	2013 Basis	2014 Basis	2015 Basis	2016 Basis	2017 Basis	5-yr Avg Basis
January	January						
February	March						
March	March						
April	April						
May	May						
June	August						
July	August						
August	August						
September	September						
October	October						
November	November						
December	January						

Notes:

- 1/ Basis is calculated as Cash - Futures. A negative sign means that futures are greater than cash.
- 2/ Cash price is for large and medium frame steers.

Describe the seasonal basis pattern for Iowa 700-800 lb large and medium frame no. 1 steers. You can just describe the basic seasonal pattern and in which month basis is the highest and lowest. Also note if there is a month that seems like an outlier. Using the 5-year average calculation to describe would be appropriate.