

# Understanding Basis and Basis Components

Presented by:

Mike Engelken  
Grain Merchandiser  
ADM Grain Company



# Overview

- By nature, commodity markets are highly cyclical, but dynamic.
- Dynamic changes in the market have included:
  - Higher demand for commodities
  - Fund activity in the futures markets
  - Utilization of transportation

# Basis Defined

- Basis is defined as the difference between the cash price at any given location for a commodity and the price of that commodity on an exchange (ex: Chicago Board of Trade).

# What Drives Basis?

- Basis is affected by many different market drivers
- The two most important drivers are:
  - Transportation Costs
  - Supply and Demand

# Calculating Basis

- Basis is calculated at a river terminal using two values:
  - Barge Freight
  - CIF Values (Gulf Values at New Orleans, LA)
- Freight is subtracted from the Gulf values to get a FOB (Free on Board) value
- Once a FOB value is established, the terminal subtracts their desired handling margin
- The result is the cash bid at the river location

# Basis Movement

- Basis generally moves up and down in response to supply/demand and transportation costs
- A “weak” or “wide” basis means that cash prices are lower than usual vs. futures prices
- A “strong” or “narrow” basis means that cash prices are higher than usual vs. futures prices

# Barge Freight

- Like corn or soybeans, barge freight is a tradable commodity
- Barge freight is subject to changes in value relative to the current bid and offer in the market
- The dynamics of the barge freight market have changed over the last 2-3 years.

# CIF Values

- CIF values are driven by relative demand for specific commodities, as well as supply available for sale at a particular instance
- CIF is merely a function of supply and demand.
- CIF values control and stabilize flow of grain and other commodities through the marketplace

# Factors affecting Basis Today

- Changes have occurred in the market that have caused basis to become historically wider.
- Changes in the barge industry, as well as changes in business and market patterns helped to drive this along.

# Factors affecting Basis Today

- Due to the very cyclical price structures of the past, the barge industry was not utilizing their fleet sufficiently.
- This caused a shrink in the barge fleet as old barges were taken out of commission, as the current freight charges did not provide for adequate return on investment.

# Factors affecting Basis Today

- Late in 2004, the world commodity market saw a surge in value that saw the barge industry accelerate their scrapping of old barges as steel prices surged.
- The surge in demand for commodities in the last 2-3 years, as well as a huge increase in northbound programs caused a dynamic shift in barge freight demand.

# Factors affecting Basis Today

- Another factor has been the increase in commodity prices
- CIF values respond to demand and available supply
- With futures moving higher and attracting new sales, the basis does not have to appreciate much to originate product to meet demand

# Factors affecting Basis Today

- If movement in the country begins to exceed demand, the CIF basis will weaken
- This will slow movement of product until such time demand improves.
- This works in an opposite manner if the market needs product
- Basis will appreciate to entice movement of product

# Basis in the Future

- As time goes on, basis levels will have ups and downs.
- Regardless of what happens, one thing to keep in mind is that markets are cyclical and have remained that way since modern marketing began.
- With higher demand in the world for commodities and high prices on commodities such as steel, look for basis to possibly continue in a wider pattern.

# Questions or Comments