

Understanding "Basis"

- Presented by...

John B. Ruff-VP-Soybeans and Grains
Procurement and Marketing
Riceland Foods, Stuttgart

Market Dynamics are Changing

- Recent action in both cash and futures defy historical patterns!
- Market dynamics are changing due to:
 - Fund activity/Investment Capital
 - Demand for commodities for ethanol/biodiesel
 - Transportation costs (post Hurricane Katrina)

"Basis" Defined

- According to National Grain and Feed Association "basis" is defined as:
- "Difference between cash price at any given location for a commodity and price of that commodity on an exchange"

Two Distinct Markets

- Cash Market
- Futures Market

Futures market limit risk only in futures, they do not cover risk in basis...

Characteristics of the Basis

- Can be at a premium to the futures price or can be at a discount to the futures price
- A 'weak' or 'wide' basis means the cash price is lower than usual versus futures prices..
- A 'strong' / 'narrow' basis means cash price is higher than usual vs. futures

The “meat” of Basis Components

- Numerous factors affect basis including:
 - Transportation Costs
 - Logistics
 - Supply/Demand
 - Level of Farmer Selling
 - Carry-out #s-large or small
 - Fund Activity
 - Storage Charges

Basis Factors

■ Supply/Demand

- When bean/wheat/corn carryouts are low, basis levels are narrow or strong;
- When these same carryouts are high due to massive production basis levels tend to be weak or wide

Basis Factors

■ Farmer Selling

- If futures price doesn't entice a producer to sell his commodity, then basis steps in, that is, it narrows, to assist futures in buying grain;
- If futures price attracts producer selling and elevators buy more grain than it needs for any given time period, the basis weakens to reflect a flooded cash market

Basis Factors

■ Transportation Costs

- Hurricane Katrina seriously challenged and likely changed the U.S. grain transportation system for many years to come;
- Grain system operating with fewer barges and large crops to move (example: 2007 crop corn)

Basis Factors

■ Cash Markets

- Primarily derived from the value of soybeans delivered in barges to New Orleans, Louisiana
- Processors vie for the same supplies of soybeans that exporters do
- Processing has its own set of values including the price of beans bought and does not necessarily mean better basis as crushing margins and processing expenses come into play