ADDING NCI FUTURES TO HEDGING STRATEGIES

Finding the right trading strategy can be challenging, especially in volatile markets. Below is a strategy to consider that reduces basis risk through a combined use of traditional, physically delivered futures contracts and MGEX financially settled agricultural index futures contracts.

The below example shows how corn hedgers can use a combination of traditional physically delivered corn hedges and the complimentary MGEX National Corn Index (NCI) futures contract to reduce basis risk. Since NCI futures contracts offer a stable country-level basis, hedgers can dedicate a portion of their hedging to the NCI futures contract and reduce their overall basis risk.

The following table shows the corn basis characteristics for North Central Iowa for the 2000-2008 crop years at various levels of NCI hedging.

Table 1. North Central Iowa Corn Basis Statistics, 2000-2008 Crop Years

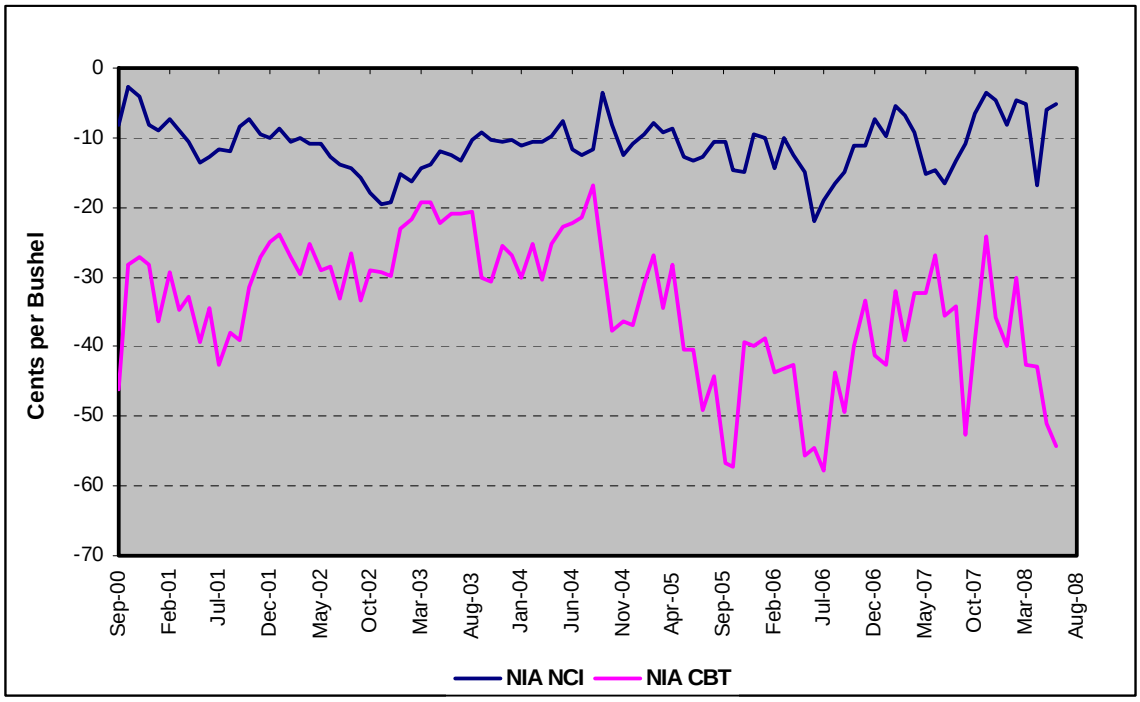
	100%	**25%**	**50%**	**25%**	**100%**
	CME	**NCI**	**NCI**	**NCI**	**NCI**
Average	**-34.2**	**-28.4**	**-22.6**	**-16.8**	**-11**
St. Deviation	**9.7**	**7.5**	**5.4**	**4.0**	**3.8**
Basis Range	**41**	**32.6**	**24.5**	**21.4**	**19.2**

As shown in the table, putting just 25% of the hedge in the NCI futures can lower basis risk. As measured by the standard deviation, the 25% NCI (75% CME) hedge reduced basis volatility by over 2 cents per bushel from 9.7 to 7.5 cents (23% decline). Likewise, the 100% CME hedge has a historical basis range of 41.0 cents. This wide-ranging basis can be reduced to under 33 cents by simply placing one fourth of the hedges in the NCI futures. Additional basis stability can be achieved by using the NCI futures contract as a complimentary tool to traditional physically delivered futures contracts when hedging corn positions.

It is practical to view the NCI futures contract as a complimentary product to existing corn futures hedging strategies. Figure 1 shows the basis behavior for a hedging program that splits 50% of the hedging into the NCI and 50% into physically delivered corn futures.

The graph illustrates that the combined program provides a much more stable basis by using this complimentary approach versus exclusively using traditional corn futures hedging strategies.

Figure 1. North Central Iowa Corn Basis, 2000-2008



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