Adding National Soybean Futures to Hedging Strategies

Finding the right trading strategy is difficult, especially in volatile markets. Below is a strategy to consider that reduces basis risk through a combined use of physically delivered futures contracts and the Minneapolis Grain Exchange (MGEX) financially settled National Soybean Index (NSI) futures contracts. The below example shows how soybean hedgers can use a combination of traditional Chicago Board of Trade (CBOT) hedges and the complimentary NSI futures to reduce basis risk. Since NSI futures contracts offer a stable country-level basis, hedgers can dedicate a portion of their hedging to the NSI futures contract and reduce overall basis risk.

The following table shows the soybean basis characteristics for North Central Iowa for the 2000-2006 crop years at various levels of NSI hedging.

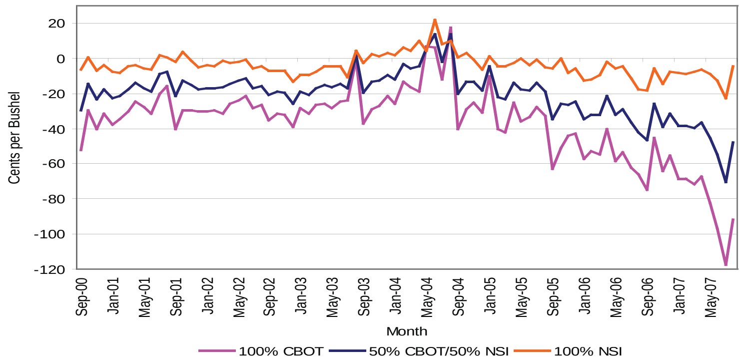
Table 1. North Central Iowa Soybean Basis Statistics, 2000-2006 Crop Years

	100% CBOT	25% NSI	50% NSI	75% NSI	100% NSI
Average	-36.76	-28.59	-20.41	-12.23	-4.06
St. Deviation	21.50	17.42	13.44	9.69	6.59
Basis Range	135.25	109.62	84.09	64.38	44.67

As shown in the table, putting just 25% of the hedge in the NSI futures can lower basis risk. As measured by the standard deviation, the 25% NSI (75% CBOT) hedge reduced basis volatility by over 4 cents per bushel from 21.50 to 17.42 cents (19% decline). Likewise, the 100% CBOT hedge has a historical basis range of 135.25 cents. This wide-ranging basis can be reduced to 84.09 cents by simply placing one-half of the hedges in the NSI futures.

Clearly, additional basis stability can be achieved by using the NSI futures contract as a complimentary tool to traditional physically delivered futures contracts when hedging soybean positions. So, it is very practical to view the NSI futures contract as a complimentary product to existing soybean futures hedging strategies. Figure 1 shows the basis behavior for a hedging program that splits 50% of the hedging into the NSI and 50% into CBOT futures. While a 100% NSI hedge provides the most stable basis, the combined program still results in a more stable basis than exclusively using traditional soybean futures hedging strategies.

Figure 1. North Central Iowa Soybean Basis, 2000-2006



MGEX
MINNEAPOLIS GRAIN EXCHANGE