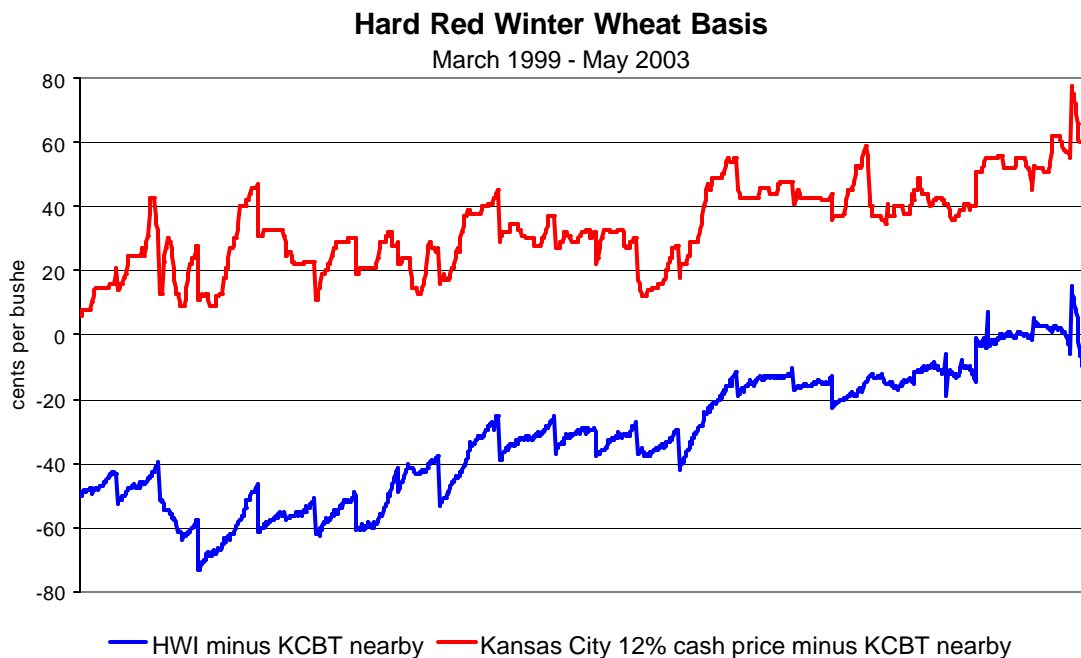


Hedging Hard Red Winter Wheat Basis

The Hard Winter Wheat Index (HWI), the settlement index for MGEX's HWI futures and options contracts, is highly correlated to the underlying cash market for hard red winter wheat. Basis can be hedged by trading the spread between HWI futures and KCBT futures. To create a synthetic **long basis** position, **buy** HWI futures and **sell** KCBT futures. To create a synthetic **short basis** position, **sell** HWI futures and **buy** KCBT futures.



The chart above compares the spot HWI versus KCBT futures spread and basis for Kansas City U.S. No. 1 HRW versus KCBT futures. The two markets track one another very closely, indicating the HWI/KCBT futures spread can be effectively used as a proxy for the cash basis.

Rule of Thumb

The average difference over the time period for No. 1 12% protein cash HRW in Kansas City and the HWI was 60 cents.

Practical Application

A purchase of one HWI futures contract at 25 cents *under* KCBT futures will roughly equate to hedging the actual cash basis for 12% protein wheat at 35 cents *over* KCBT futures.

Other Applications

Options can be used to create synthetic long or short basis positions. For example, buying a call option on HWI and selling a call option on KCBT creates an option on the HRW basis.



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