COLORADO STATE UNIVERSITY
DEPARTMENT OF AGRICULTURAL AND RESOURCE ECONOMICS

Handout **Agricultural and Resource Economics 412** *S.R. Koontz*
Fall 2023 **Agricultural Commodities Marketing**

The following is a list of the important topic and question areas for the first portion of the course.

- What is a futures contract? What are options? How are forward contracts different from? What are important risks? What is a futures exchange? What are the functions of exchanges?
- Why do businesses and people trade futures contracts?
- What is the clearinghouse? What are the functions of the clearinghouse?
- Who regulates the futures industry? What professionals are members of the futures industry and what do they do? Describe the paperwork involved with trading futures contracts.
- Margins: initial margins, maintenance margins, marking-to-market, and margin calls.
- The trading process, the order flow, and electronic orders.
- Criteria for perfect competition and the structure of futures markets.
- The two roles or economic functions of futures markets: price discovery, and forward pricing and risk transfer. Summary and understanding of both.
- What are the implications to traders that come from the ideas behind price discovery?
- The two facts that make hedging effective: cash and futures markets move in parallel, and cash and futures prices converge to a predictable difference. What do we mean by an effective hedge?
- Measurement of risk. How is return measured and how is risk measured? Risk and return tradeoff. How are probabilities of good and bad outcomes calculated?
- Delivery, the threat of delivery, and cash and futures market arbitrage.
- Basis: terminology, calculation, use. Why is basis needed? Interpretation of basis table.
- Hedging mechanics: T-account, contract selection, forward price, expected and actual basis, and net price.
- Hedging involves the exchange of basis risk for price risk.
- Grain basis: delivery costs, transportation costs, storage costs. Long-run factors that affect the average level of basis. Short-run factors that affect basis variability. Storage hedge.
- Yield risk: uncertain production and negative correlation between cash and futures market revenues.
- Livestock basis: delivery costs, surplus/deficit location, animal weight and quality, season. Short-run factors that affect basis variability. Using basis in a livestock budget.
- Example alternatives to hedging: basis contract and flat price contract.
- Hedging evaluation: basis risk, yield risk, commissions, margin money, risk premium. Decision versus outcome. Communicate an understanding of all.