FUTURES MARKET EXPLAINED

Farmers have to cope with various risks in agriculture. But they can also manage some of the threats posed by volatile market prices by participating in the futures market. This video can help better understand how the futures market supports both producers and users of a major commodity, such as corn.

1 **VIDEO. Wtach this video and comment.**

Futures market explained

A three-dollar box of corn cereal stays at roughly the same price day-to-day and week-to-week, but corn prices can change daily, sometimes by a few cents, sometimes by a lot more. Why does the cost of processed foods generally stay quite stable, even though the crops that go into them have prices that fluctuate? It's partly thanks to the futures market. The futures market allows the people who sell and buy large quantities of corn to insulate you, the consumer, from those changes, without going out of business themselves.

Let's meet our corn producer, this farmer. Of course, she is always looking to sell her corn at a high price. And, on the other side, our corn user, this cereal company, is always looking to buy corn at a low price. Now, the farmer has a little bit of a problem, because her whole crop gets harvested at once. Lots and lots of farmers will be harvesting at the same time, and the huge supply can send the price falling. And even though that price might be appealing to the company that makes cereal from corn, it doesn't want to purchase all of its corn at once because, among other reasons, it would have to pay to store it. But it's fortunate that corn can be stored, because that means it can be sold and bought throughout the year. And this is where the futures market fits in.

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Buyers and sellers move bushels around in the market, though actual corn rarely changes hands. Instead of buying and selling corn, the farmer and cereal maker buy and sell contracts. Now we're getting closer to peace of mind for both sides, because a futures contract provides a hedge against a change in the price. This way, neither side is stuck with only whatever the market price is, when they want to buy or sell. These contracts can be made at any time, even before the farmer plants the corn. She'll use the futures market to sell some of her anticipated crop on a certain date in the future. Of course, she's not going to sell all of her corn on that contract. Just enough corn to reassure her that a low price at harvest won't ruin her business. The contract provides that security. The cereal company uses the same market to buy bushels. Their contract protects against a high price later. Contracts will gain or lose money in the futures market. If the price goes high, the farmer loses money on that futures contract. Because she's stuck with it.
But that's okay, because now she can sell the rest of her corn – what wasn't in that contract – at the higher price, that offsets her loss in the futures market. If, at harvest time, the price of corn is low, well, that's exactly why she entered the futures market: the low price means her contract makes money. So, that profit shields her from the sting of the low price she'll get for the bushels she sells now. A corn cereal company doesn't like those higher prices, and that's why they have a futures contract. They make money on it and can use that profit to cover the higher price of the corn they now need to buy. The futures market serves as a risk management tool. It doesn't maximize profit, instead, it focuses on balance, and in this way, it keeps your cereal from breaking your weekly shopping budget.

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