



## ADDING MGEX HRSI 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 (Minneapolis Grain Exchange) financially settled Hard Red Spring Wheat Index (HRSI) futures contract.

This example shows how spring wheat hedgers can use a combination of traditional physically delivered wheat hedges and the complimentary MGEX HRSI futures contract to reduce basis risk. The wheat index futures contract reflects country-level elevator bids. This offers a more stable country-level basis than traditional delivery-based wheat futures contracts.

Incorporating new components into a hedging program is often difficult. However, hedgers do not need to radically alter their hedging routine to benefit from the improved basis offered by MGEX HRSI futures contract. Hedgers can dedicate a small portion of their hedging to the index futures contract and still reduce their overall basis risk as illustrated in the table below. A combination of the two contracts can provide them with many of the benefits of the financially settled HRSI contract.

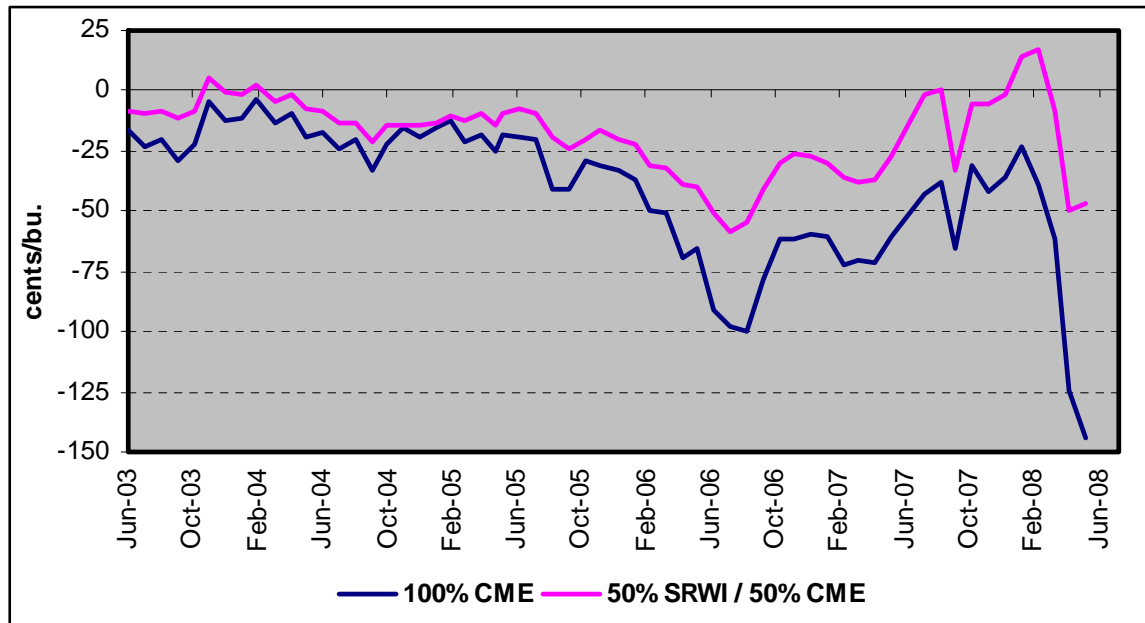
Table 1 shows the basis statistics for varying levels of hedging in both MGEX spring wheat futures and the HRSI contract. As shown in the table, putting just 25 percent of the hedge in the HRSI futures can lower basis risk. As measured by the standard deviation, the 25 percent HRSI hedge reduces the basis standard deviation from 40.3 cents to 33.9 cents (16 percent decline).

Additional allocations to the HRSI contracts can further reduce basis risk for country-level hedging in Northeast Montana. Recent large swings in basis values could have been partially dampened by holding a 50 percent HRSI hedge as illustrated in Figure 1.

**Table 1. Hard Red Spring Wheat Basis Statistics, NE Montana, 2004-2008  
Crop Years**

	<b>100%</b>	<b>25%</b>	<b>50%</b>	<b>25%</b>	<b>100%</b>
	<b>MGEX</b>	<b>HRSI</b>	<b>HRSI</b>	<b>HRSI</b>	<b>HRSI</b>
Average	-24.8	-19.3	-13.8	-8.4	-2.9
St. Deviation	40.3	33.9	28.7	25.3	24.6
Basis Range	187.5	181.4	175.2	169.1	163.0

**Figure 1. NE Montana, Hard Red Spring Wheat Basis, 2004-2008**



Additional basis stability can be achieved by placing a portion of wheat hedges in the MGEX HRSI contract. In addition to the HRSI, MGEX offers index futures contracts for Soft Red Winter Wheat (SRWI) and Hard Red Winter Wheat (HRWI). These futures contracts should be viewed as complimentary tools to traditional physically delivered futures contracts for hedgers. Potential users of the MGEX wheat index futures contracts should not take an “all or none” approach to the index contracts. Rather, they should incorporate them as additional risk management tools to enhance current hedging strategies.