



ADDING MGEX SRWI 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 financially settled Soft Red Winter Wheat Index (SRWI) futures contracts.

This example shows how soft red winter wheat hedgers can use a combination of traditional physically delivered wheat hedges and the complimentary MGEX SRWI futures contract to reduce basis risk. The SRWI 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 SRWI futures contract. A hedger can dedicate a portion of their hedging to the index futures contract and 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 SRWI contracts.

Table 1 shows MGEX SRWI basis characteristics for Northwest Ohio. Each column represents a different level of hedging in the SRWI futures contract, ranging from 0 (far left column) to 10 percent (far right column).

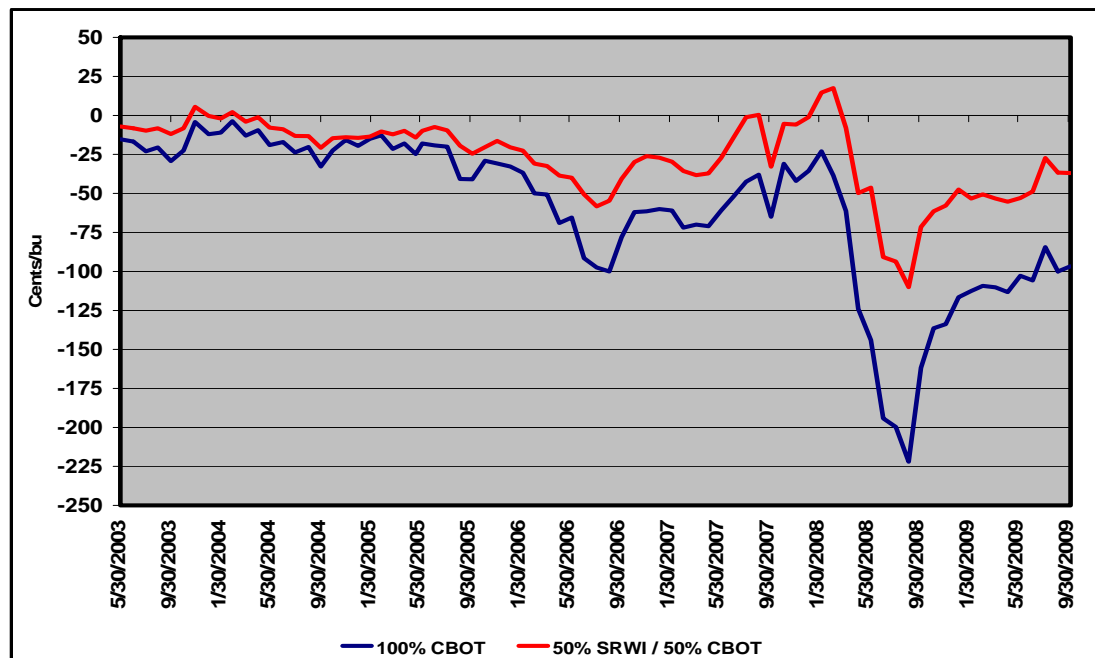
As shown in the table, putting just 25 percent of the hedge in the SRWI futures contract can lower basis risk. As measured by the standard deviation, the 25 percent SRWI (75 percent CBOT) hedge reduced basis volatility by 6 cents per bushel from 26.4 to 20.4 cents (23 percent decline). Similarly, the 100 percent CBOT hedge has a historical basis range of 120.3 cents, which can be reduced to just over 75 cents by placing one-half of the hedges in the SRWI futures contract.

Table 1. Soft Red Winter Wheat Basis Statistics, Northwest Ohio, 2003-2008 Crop Years

	100% CBOT	25% SRWI	50% SRWI	25% SRWI	100% SRWI
Average	-39.5	-28.5	-17.4	-6.4	4.6
St. Deviation	26.4	20.4	16.2	15.1	17.8
Basis Range	120.3	87.5	75.8	84.2	92.6

The impact of placing hedges in the SRWI is illustrated in Figure 1, which shows the basis behavior for a 100 percent CBOT hedge and a 50 percent CBOT / 50 percent SRWI hedge. Clearly, the SRWI helps to reduce basis fluctuations. Placing a portion of wheat hedges in SRWI contract should be considered complimentary to existing hedging programs using CBOT futures.

Figure 1. Northwest Ohio, Soft Red Winter Wheat Basis, 2003-2009



Additional basis stability can be achieved by placing a portion of wheat hedges in the MGEX SRWI contract. In addition to the SRWI, MGEX offers index futures contracts for Hard Red Spring Wheat (HRSI) 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 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