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THE FARMER'S EDGE

Hurley & Associates
Agri-Marketing Centers

Wisdom vs. Technology

By Ida Hurley
(written March 2003; revised March 2019)

Technological advances have produced so many changes in our society that we are forced to constantly learn in order to adapt. In the last 45 years, U.S. corn yields have risen from 70 to over 176 bushels per acre, the internet has made communication instantaneous, and medical technology has enabled us to live longer, healthier lives.

While technology is ever changing, one thing never changes - - wisdom. We are more intellectual, but are we wiser? The wisest man who ever lived, said in Proverbs 9:10, "The fear of the Lord is the beginning of wisdom: and the knowledge of the holy is understanding."

To grow a crop takes hard work, discipline, intelligence and a lot of faith that your hard work will pay off. It takes wisdom, however, to know how to manage all of the elements of your farming operation. Wisdom is defined as knowledge and the capacity to make due use of it.

Technology in and of itself has not made farming more profitable? Why?

1. Failure to identify our real mission in life. It is hard to put a puzzle together without looking at the picture on the box. If we do not know our purpose, we will not recognize the opportunities that come our way to accomplish the mission. This takes wisdom.
2. Looking at our operation as a whole instead of those pieces of the puzzle is an important key to success. Our society is losing its respect for authority and God-given principles. Without belief in divine authority, there is no order. The result is that we use man-made rules, as opposed to sound principles. All of us realize that the principles governing seedtime and harvest cannot be broken.

   True wisdom recognizes certain other inviolable principles: financial principles, marketing principles, and the principles governing relationships for a strong farming operation and a strong family. We should use all these principles to:

   - lay a proper foundation for a strong family,
   - build our business as a profit center,
   - acquire assets for the purpose of returning a profit, and
   - build our house.

   All of this takes wisdom and accountability – in addition to knowledge.
3. There are many new tools we can use to manage risk. To get a client to really identify what risk means to

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SERVING AGRICULTURAL PRODUCERS SINCE 1988
CELEBRATING 30 YEARS

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them, in light of their mission statement, is probably one of our hardest jobs. That is why profitable opportunities in the market can come and go, and farmers do not pull triggers. They cannot visualize the money that the market is offering them deposited in their bank account.

Without accurate accounting records that show when they have a profit, many producers are lulled to sleep. Many also do not realize that out of profits, debt must be paid. Therefore, with no idea of profitability, money is borrowed on assets instead of profitability. This starts the debt snowball. Debt is the problem not profitability. No technical tool can replace the wisdom it takes to make decisions based on correctly identified risks.

The second most vital job is to teach our clients to use tools, such as options, for insurance. Example: If we buy a put, and the market goes down, we show income in the futures account and the accountant thinks we did a great job, never mind that our cash grain was sold at low prices. On the other hand, if the market goes up, we sell cash grain at good prices, but the options expire worthless. The 1099 from the commodity account shows a loss, and options are deemed as having been worthless.

No thought is given to the fact that the farm was protected from the downside, and would still profit from any market advances.

There are other futures and options strategies we use, or could use, but if the farmer is reluctant to use them because they would panic on the first requirement of additional money needed to fund the position, emotion takes over, and all parties involved tend to make irrational decisions.

Anytime you make a decision based on emotions, you are not using wisdom. The tools only work in our favor when we use wisdom.

4. Communication is one of the most important elements in success. We should communicate with family, employees, banker, crop consultant, insurance agent, marketing consultant, and suppliers. All of these individuals play an important role in our operation. Often, we fail to communicate when something is threatening; this leads to suspicion and mistrust. A banker, for instance, will usually go the extra mile with someone who keeps them informed. Communication is very hard at times, but the person who communicates at every level is very wise.

Technology without wisdom cannot give us anything in life that is satisfying or rewarding. As we have pointed out many times, agriculture needs leadership. It needs the type of leadership that builds hope into the agricultural industry, not despair. Anytime we have change, we have opportunity. Seek and use wisdom.

"Agriculture is our wisest pursuit, because it will in the end contribute most to real wealth, good morals, and happiness."

– Thomas Jefferson

Federal Reserve Open Market Committee Meeting Draws Attention

By John A. Johnson

Market watchers of all stripes are watching the FOMC as they enter their March two-day meeting to decide monetary strategy for at least the next few months.

During the financial crisis of 2008, the Fed began what was to become nearly 6 years of Quantitative Easing, affectionately known as QE by its banker friends. The Federal Reserve was purchasing bonds with money printed out of thin air. This money was then lent to its member banks for re-lending, thereby stimulating an economy which was on life support.

This action by the Fed literally pumped money into the economy to the tune of some $4.5 trillion, beginning with a rate of $85 billion per month, (and after a few stops and starts, known as QE2, QE3 and QE4), they were down to as little as $15 billion per month. The program known as QE stopped altogether in the fall of 2014.

In the spring of 2018, the bank decided that some tightening was in order and began drawing some $50 billion/month out of the system. This phase of the program was known as Quantitative Tightening. December of 2018 found an economy that was beginning to show serious signs of slowing down. The stock market was getting very wobbly, unemployment was leveling off and consumer spending was beginning to flag.

The Fed promptly announced a moratorium on withdrawals, and even indicated that if things got serious

Thanks to Topdown Charts and Callum Thomas for the use of this chart.

enough they wouldn't hesitate to begin QE again. Now, with wounds still smarting from the last economic mini-contraction, traders, investors, savers and consumers around the world are holding their collective breaths as the committee convenes again.

We would be remiss in our discussion of world events affecting agriculture if we didn't mention the floods in Nebraska, South Dakota, Iowa and Missouri. We have no idea of the ultimate toll in life and property at this time, but we know that those areas will be feeling the financial and emotional trials of this event for a long time to come. We have lost lives, homes, roads, bridges, crops, livestock, equipment, facilities, feed, cash grain and so much more. Our hearts and prayers go out for those who have suffered losses there.

While not as severe as the Northern flood, the Ohio River Valley too is struggling with an excess of rainfall. The Ohio and Lower Mississippi Rivers are to capacity, and over in some cases. For those of us at the confluence of these great rivers, we will see a lot of water before this spring is over.

The world's economy is embroiled in so many controversies that affect international trade that it is nearly impossible to predict movement of products and services from day to day, much less on any long term pattern. The U.S., Canada and Mexico are cautiously feeling our way along with the recently agreed to version of NAFTA, while the "Sherpa's" within the administration are involved in ongoing meetings with the Chinese over mutual trade concerns.
We were informed by the media that we were very close to a deal with the Chinese, and that there was a meeting being scheduled between President Xi Jinping of China, and President Trump to sign the final agreement, but that meeting has been postponed until further notice.

Farmers are very nervous about any such meeting as the Chinese are the major buyers of the world's export soybeans among other things. If the final decisions are made in June or July, it is too late for our soybean farmers to make any cropping adjustments to accommodate a Chinese trade deal, or the lack thereof.

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Challenges of Beginning Farmers

By Lynn Weeks

In the United States, 1% of the population are farmers, and out of that, 7.8% are under the age of 35. In our area of the Mississippi delta, I would say those numbers are close. I would also say that I do not know a single young farmer who was able to start farming on his or her own. Everyone that I know has had some relative to help them get started … or they had a non-relative that didn't have anyone in their family that was interested in farming the ground. One thing I do know for sure is that just because they had help with their start in farming it wasn't an easy ride. And, it still isn't for some.

Farming is a challenging job, with long days that start early and go late. Days that are filled with various physical demands from running the tractor, sprayer and combine, to fixing equipment. These demands are complicated by the need to stay current on best practices to increase efficiencies in production, to pay attention to labor management, to meet the financial requirements of what is a capital-intensive business, and to keep focus on fast-moving commodity markets in order sell their crops in hopes of breaking even and making a profit. These challenges are even more of a hurdle for young, beginning and small farm operators.

One of the biggest obstacles young and beginning farmers face is limited capital to buy or rent land, to purchase equipment, or to acquire inputs like seed and fertilizer. They also typically have limited equity in their farm operations, making it difficult to acquire either an operating line of credit or a real estate loan through traditional programs.

In the recent past, we have seen a surge in the price of new equipment so the solution to that for a beginning farmer was to buy used equipment. That seemed to work up until the last couple of years when the cost of used equipment also rose significantly. I talked to a local auctioneer and an equipment jockey and they both agreed that used equipment in our area has increased 10-15% the last couple of years. So, to combat some of this, young farmers are spending more time implementing preventative maintenance programs. This allows them to keep using older equipment and to reduce repairs and downtime in the most important time windows of planting and harvesting.

Land accrual has also become a challenge for young producers with the cost of purchasing land out of reach for most and the competition of rented land becoming more of a slugfest between local producers. One thing that seems to work for some landlords is creative rent structures. All of this is still up to the landlord, but with some ingenuity from the producer, there could be a good relationship between the two. It is all about thinking outside the box!

To go along with the above, we have also seen some downsizing with rented land not being renewed. Back when commodity prices were strong and larger farms wanted to become larger … it didn't seem to matter what the rent cost was. However, now that commodity prices have fallen and all other cost seemed to have remained the same, farmers have calculated out which ground makes money, which breaks even, and which is losing money. The ground that is losing money is the first to be cut loose, since it has to be propped up by the rest of the operation's income.

Even some of the breakeven ground is being turned loose with the thought process that even though it isn't actually losing money, it is costing extra time and wear and tear on equipment, which does turn into lost dollars. This allows young farmers to put more focus into the higher producing ground and to free up some more dollars to invest in those acres.

While it is true that most young farmers do not have significant capital levels, their ability to demonstrate that thinking outside the box and doing things, sometimes unconventionally, helps to save themselves time and money. This should allow producers to help show their ability to repay the new debt they are seeking by developing realistic projections of income and expenses, and identifying their breakeven points. Young farmers should always listen to the ones that helped them get started because years of experience speaks volumes, but it doesn't hurt to be creative and try new things and step out of your comfort zone.

Federal Reserve Open Market Committee Meeting Draws Attention

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Meanwhile President Trump is meeting with his counterpart from Brazil, Brazilian President Jair Bolsonaro. Reports are that President Trump intends to designate Brazil as a non-NATO ally.

"As I told President Bolsonaro, I also intend to designate Brazil as a major non-NATO ally or even possibly, if you start thinking about it, a NATO ally. We have to talk to a lot of people, but maybe a NATO ally," Trump said.

At one point, President Trump said, "The relationship we have now with Brazil has never been better."

Brazil has indicated that it hopes to see itself elevated to "major non-NATO ally" status by the Trump administration, a major step that could help it purchase military equipment.

Our agricultural export business to South Korea and Japan continues to go very well as their import of our beef keeps U.S. supplies in balance with demand at a very favorable price to producers.

"When it is understood that one loses joy and happiness in the attempt to possess them, the essence of natural farming will be realized. The ultimate goal of farming is not the growing of crops, but the cultivation and perfection of human beings."

– Masanobu Fukuoka

Consultant Spotlight: SHAUN RAUSCH

What do you most enjoy about your job?
The combination of working alongside a talented team of co-workers and partnering with producers and their families each day is extremely enjoyable. The relationships generated with these individuals are worth their weight in gold.

How did you get started in your career?
During my time at SDSU, I enrolled in an Ag marketing class and immediately became passionate in furthering my education. I was made aware of an internship available with Hurley & Associates. After completing it, I knew that Hurley was a company that I wanted to be a part of.

What are you most passionate about when it comes to serving clients?
Creating a relationship based around trust, respect and good communication. Once those traits are formed, partnering with my clients to establish an individualized marketing plan that is based on sound business decisions is very rewarding.

What would be your ideal vacation?
Renting a cabin on a lake with a pontoon with my family.

Shaun grew up on a family farm near Gettysburg, SD where they raised corn, soybeans, wheat, sunflowers and cattle. He attended South Dakota State University and graduated with degrees in Business Economics and Ag Business, along with a minor in Ag Marketing. Shaun has continued his pursuit of education in agriculture by participating in SDARL (South Dakota Ag & Rural Leadership). Shaun began working for Hurley & Associates as an intern on September 1, 2006 and started full time on January 2, 2007. By combining his farming background and education, Shaun has obtained a great deal of knowledge in both farm production and agricultural marketing and finance. He now enjoys using this knowledge to partner with farmers in developing individual marketing plans based on sound business decisions.

Shaun married his wife, Tasha, in June of 2010 and the couple currently resides in Brookings, SD with their three children.

When possible, he enjoys getting back to the family farm to help out and to spend time with family. Growing up near the Missouri River, Shaun has always enjoyed spending time on the water, whether it is skiing or fishing. He also enjoys participating in a variety of other athletic and outdoor activities.

Setting Floors on New Crop

Hurley & Associates' consultants work hard to gather information unique to each of the farmers we work with. Those differentiators help us to build market plans that consider those variables as market opportunities present themselves.

Our best sales opportunities typically come when uncertainties exist in the market. That uncertainty is biggest in the spring, before planting is accomplished. It is wise to take advantage of that seasonal timeframe and market opportunities presented to set floors. The problem is that the **uncertainty often blinds us to the opportunity and paralyzes us from taking action**. The tendency is to do nothing when we should be taking steps to protect the farm.

Here are some thoughts on the primary ways that Hurley likes to go about setting floors:

1. The most simple and most manageable way to set floors is to sell the cash grain (or sell futures) and buy a call. Our floor is the cash price we receive from the sale minus the cost of the option. Call options give us the confidence to take action on a marketing opportunity because they provide us with protection against the production and price uncertainty yet to come, as well as protection against unlimited margin risk on hedge positions in your futures account.

   Calls can be purchased at-the-money or out-of-the money. An at-the-money call will provide you with better protection but it will cost you more. An out-of-the money call is cheaper to purchase and will give you protection should the market rally in a big way. As a guideline, we typically spend about five percent (give or take) of the commodity's value on hedge tools. In other words, if we are protecting $4.00 corn futures we would look for call options that cost about 20 cents.

2. We can also buy puts to set a floor and protect against a downside move. The strike level minus the cost of the put is our floor and, if the market goes up, we have the cash grain to sell at a higher price. The big advantage of puts is that we can set a floor to protect a healthy financial outcome for the farm without making a delivery commitment in the cash market (a synthetic put using futures/calls would accomplish that as well).

   Puts can also be purchased at-the-money or out-of-the money. If you wish to buy a put and sell a call to finance the purchase, it can also be done. It must be noted, however, that buying a put and selling a call is a marginable position and you may be required to send more money into your hedge account if the market moves higher once the position is established. Buying puts/selling calls is an aggressive marketer strategy and should only be entered into if you understand and can accept the risks involved.

When we set a new crop floor that includes the purchase of a call or put, that coverage is generally maintained until the market and/or production risk is gone or until a targeted market goal is obtained. For example, if we have purchased puts as a floor and are then able to sell cash in a higher market, we would remove the put protection for the sold bushel quantity. If we have sold the cash and purchased a call, we can liquidate the call any time a market goal has been met if the production risk is gone. If production risk still exists when a call option has gained substantial equity, we can roll the option up to preserve some of the equity and still maintain risk protection. We can never guarantee that a particular value will be salvaged from an option since we cannot know what the market will do before the production risk is over and we are comfortable liquidating the option.

In addition to these fundamental ways to set market floors, we do have several additional strategies that may also work for your farm operation. Talk to your consultant if you wish to explore them. Remember that any time a strategy includes an option that is sold, you have risk. Each strategy needs to be assessed to determine whether the inherent risk is something you are willing to assume.

We need to work together to set floors in a way that is comfortable for each individual producer and, ideally, that are part of an individualized market plan that has been developed for your farm.

Call Options

Market volatility keeps the value of your production in a state of flux. Eventually, a marketing decision to convert inventory to cash has to be made. A serious crop problem in South America or acre questions in the United States can cause price exploration to the upside. In spite of how much time we spend talking about crop problems, however, a good crop is the norm and betting on a serious crop problem to market your grain is a long shot.

If you have grain in storage, your decision to sell is as much logistical as anything. For example, are you paying storage? Will the basis improve? Can you wait for a summer price rally? However, if you have not protected against a downside price move, you have serious price risk and no guarantee or what you will lock in for your bottom line. Do not get caught up with the idea that prices cannot go lower because they can. If crops go in the ground this spring in good condition and if rains are timely this summer, prices could go a lot lower.

If you are holding old crop grain with no downside price protection, we encourage you to move your marketing position from an unknown risk to a known risk. You can do this by selling cash bushels and buying a call option. If you are paying for storage, you will stop storage and interest costs, get the cash working for you and eliminated further price risk deterioration. Your only risk will be the cost of the option.

The call option will provide you the opportunity to make money should prices rise sharply. There are many strategies to consider when buying calls. You need to choose your strike price, expiration month, and premium cost. The purchase of a call option on its own is straightforward, fairly easy to understand and to manage.

Producers with a good understanding of options can also use what is known as a bull–call spread (also known as a covered call) to lower the option costs. This strategy involves buying a call and selling a higher priced call. Your net option cost will be reduced; however, you give up any profit above the sold call strike price.

Hurley & Associates believes positions are unique to each person's risk bearing ability; marketing strategy; and crop conditions, therefore we give no blanket recommendations. The risk of loss in trading commodities can be substantial, therefore, carefully consider whether such trading is suitable for you in light of your financial condition. NFA Rules require us to advise you that past performance is not indicative of future results, and there is no guarantee that your trading experience will be similar to past performance.

"The farmer is the only man in our economy who buys everything at retail, sells everything at wholesale, and pays the freight both ways."

– John F. Kennedy

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