What are the top grain trading marketing strategies?

by StoneX

When it comes to grain trading, basis is a vital concept to grasp. It denotes the difference between a commodity's local price and its current price on the futures market: Basis = cash market price + or – futures market price. For grain producers and speculators, basis plays a major role in whether crops are taken to market or stored to sell later.

Being able to recognize discrepancies between the cash and futures markets is a key skill successful grain traders possess. In this article, we'll break down what basis means to the markets and a few strategies for capitalizing on variance.

Basis 101: Under and Over

At first, the idea of basis can seem overwhelming. However, understanding what drives basis levels can remove that uncertainty and help to navigate the basis environment, most specifically are the fundamentals indicating basis exposure or basis opportunity.

Assume that Carey is a canola grower in Central Saskatchewan who is strategizing on how to optimize returns on this year's crop.

Early in the planting season, Carey takes a close look at both canola futures pricing and the local basis bids in central Saskatchewan. As it applies to grain trading, two forms of basis will play large roles in Carey's marketing plan: over and under.

On April 15, Carey checks the new crop canola prices at local crush plant and it shows a posted bid of $920 per MT. The ICE November 2022 canola futures shows a settlement price of $950 per MT.

The basis is as follows:

- Futures – Basis = Cash
- $950 – $30 = $920

The new crop September 2022 basis for canola in central Saskatchewan is - $30 per MT, or "30 under Nov." With a negative basis, or cash prices under the futures price, there is ample regional supply or demand is simply covered off at this time. For local producers, management decisions such as cash flow, logistics, storage constraints and storage risk come into place. There are also historical or seasonal basis levels to help with this marketing decision. Every crop year is different but the decision now is do I market or store this year's crop? For producers with self-storage capacity and a steady cash flow, it may be best to store instead of market.

Now, let's say that central Saskatchewan canola prices are significantly stronger, coming in at $970 per MT while November ICE futures trades at $950 per MT,the grain trading basis flips:

- $950 + $20 = $970

Now, Carey's September 2022 basis is + $20 or "20 over Nov." A positive basis, or the cash price over futures, suggests that local supplies are short. This places local producers in a strong position relative to the aggregate market. In this case, marketing at harvest time may be the best course of action.

Grain Trading 101: Long and Short the Basis

Given Carey's potentially long or short basis positions, are there any strategies that can help maximize profits while limiting risk? Yes. By going long or short the basis, Carey can market this year's crop from a position of strength.

As harvest approaches, it's decision time for Carey. Canola basis bids in central Saskatchewan remain firm and above historical levels. Carey can short the basis with 2 marketing strategies. Sell basis only leaving the November 22 futures component open, or sell a Deferred delivery contract pricing both the futures and basis component open, or sell a Deferred delivery contract pricing both the futures and basis component. Either of these strategies still allow for logistics and bin space.

If Carey's outlook of the market is basis "opportunity" but does want to mitigate downside risk potential of the futures market, Carey can remain long basis but short the canola futures with a financial hedge or a Futures First contract with local crush plant. This allows Carey to leave the basis component open for now, and can choose to lock basis in anytime prior to delivery of the canola.

Regardless of comfort level on grain marketing strategies, canola producers are basis traders as that is a major component in the flat price they hedge at, so learning the key indicators that drive basis levels will help to execute a structured hedge plan.

Interested in Learning More About the Ag Markets?

Basis? Over? Under? Without question, the ag markets have a language all their own. If you're interested in learning more about the ag markets, a great place to begin is with a free consultation with an ag expert from our partner, StoneX.