A quick look today, September 6th, shows December 2012 corn futures at $7.98, soybean meal at $528, alfalfa hay ranging on average from $125 (grade 2) to $277 (prime) per ton, and December milk at $19.80. It leaves one a bit stunned. Selling milk for $19 plus sounds great, but it is the difference between that price and feed and other costs that puts profits in one’s pocket. More confusing yet, what do these prices and the volatility that is sure to follow mean for next year? As we come out of this drought how are these prices expected to change, what does it mean for profit margins, what can I do to protect myself, and are there operational changes I should make?

Answering those questions could be made quite simple if someone would just tell me what prices are going to be next year! There are many excellent commodity price experts in UW-Extension and in other organizations and states that are very good at understanding and explaining the fundamentals of current prices, what the variables are that can impact future price movement, and even the direction of movement that those variables suggest. But, it is a volatile world with many moving parts and the business of analyzing future price movement and where those prices will settle is a tough and complex challenge even in normal times and we are not in normal times!

How many cows will be slaughtered which would decrease feedlot placements which would decrease corn consumption? How will other production and consumption around the world respond to price signals? Will ethanol consumption change even if RFS standards are relaxed and if so by how much? How will producers shift acreage intentions next spring? How will the world respond to high prices - alternative uses, different rations, and changes in enterprises? What will happen to currency exchange rates, income in nations that trade with the U.S., and what will be the financial situation in Europe?

Price forecasts are a very important piece of information for farm and price risk management, but the farm manager needs to keep perspective, especially in these volatile times, that it is “a” piece of information not “the” piece. Price forecasts will be right and they will be wrong, some will be really wrong. Ask yourself, what were the forecast for this Fall’s corn, milk, and other prices last April?

One suggestion is to focus not on price, but on profit margin. For example, today the average futures milk price for the next 12 months is $19.16. Today, I perhaps know what I have for feed, what I’ll need for feed, my cost in that feed, and an estimate of other costs. What cash prices will be six months or a year from now is very volatile and very uncertain, but I do know with exact certainty today’s futures prices six months or a year from now (as of today May 2013 milk is 18.83, corn is $7.97, and soybean meal is $469). Thus, given these known futures prices and other costs that I can estimate I have fair amount of certainty today what my potential profit margins will be in the future if I act to secure that margin. The first question to ask is whether or not I like the profit margin I see, is it a rate of return on my investment that is good for my business and my situation?

A second set of questions can be asked and here the price forecasting experts can be of great help. Are prices expected to move in ways that might create greater margins? If not, then a prudent management
decision would be to take action and secure the margins that exist today. If forecasts do call for greater potential margins then one can either wait, or secure today’s margins in ways that allow taking advantage of future price movements while not losing today’s margin value. However, always remember that today’s forecast may be quite different once world events unfold in the months ahead.

The worst case scenario is that the margins I see today are not good and the forecasts only look worst. Even in this case focusing on margins will help in preparing and making management decisions and operational changes now when alternatives might still exist versus later when the choices will be more limited. The point is, by estimating margins using futures prices and other costs that are known farm managers have the ability to evaluate with some level of certainty and act accordingly in a time frame that allows for alternatives versus letting prices happen to us and being left with no time to act. In one case we manage prices while in the other prices manage us!

One forecast that is almost a certainty is that prices are likely to move, move significantly, and move in ways that are unpredictable. One can quickly become paralyzed trying to follow the gyrations of prices. Better to focus instead on what at the end of the day is most important – profits. Price forecasts are an important tool, but use them to adjust how you manage your profit margins.

In conclusion, two bits of wisdom from other agriculturalist:

1. A lender once told me that the farm manager that consistently manages for positive profit margins will sometimes not end up with the highest profit margin that year due to the decisions they made, but they will be here next year to decide again!
2. “What the markets will look like in 6 or 12 months is a real crap shoot.”

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For more drought information consult your county Extension agent and see the UW-Extension Drought 2012 website at http://fvi.uwex.edu/drought2012/.