



CRC

for

Premium

Quality

Wool

Exchange Traded Forward Contracts (Futures Contracts)

Produced for the CRC for Premium Quality Wool undergraduate program by;
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What is a futures contract ?

- **Legally binding agreement**
 - Sydney Futures Exchange (SFE)
 - third party
- **To buy or sell wool at some time in the future**
 - Each contract standardised for quality and quantity
 - Contracts with different delivery months

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Forward vs. Futures

<i>Forward</i>	<i>Futures</i>
Tailor made	Standardised
Non regulated market	Regulated
Delivery always occurs	Delivery may occur
Trade only with organising party	Substitute one contracting party with another one
Counter party risk	Minimal risk, Clearing House guarantees performance

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General Contract Specifications

Unit	2,500 kg clean
Quality	19, 21 and 23 μm 19 and 23 based on MPG 21 based on MF5B type
Tolerances	2250 to 2750 clean kgs
Months	Feb, April, June, Aug, Oct, Dec

Refer to your broker for exact specs.

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Why use a futures contract over other pricing methods?

- Flexibility, get in and out of the market relatively easily
- Woolgrower able to sell the physical wool in their preferred manner
- Convenience

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HOW DO FUTURES WORK ?

Example 1 - Cash price falls

A woolgrower produces 40 bales of 21 micron fleece wool. Shears in November and sells in December. It is now June. Current market is at 700 cents/kg.

	<i>Physical</i>	<i>Futures</i>
June	<ul style="list-style-type: none">• Intends to sell wool in December.	<ul style="list-style-type: none">• Sells December futures at 700 cents/kg
December	<ul style="list-style-type: none">• Sells wool for 650 cents/kg	<ul style="list-style-type: none">• Buys December futures at 650 cents/kg• <u>Profit</u> on futures = 50 cents/kg

Price realised = 650 cents + 50 cents = 700 cents/kg.

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HOW DO FUTURES WORK ?

Example 2 - Cash price rises

A woolgrower produces 40 bales of 21 micron fleece wool. Shears in November and sells in December. It is now June.

	<i>Physical</i>	<i>Futures</i>
June	<ul style="list-style-type: none">• Intends to sell wool in December.	<ul style="list-style-type: none">• Sells December futures at 700 cents/kg
December	<ul style="list-style-type: none">• Sells wool for 750 cents/kg	<ul style="list-style-type: none">• Buys December futures at 750 cents/kg• <u>Loss</u> on futures = 50 cents/kg

Price realised = 750 cents - 50 cents = 700 cents/kg.

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Margin Calls

Ensures financial integrity of the marketplace

- **Initial Margin**
 - % of every contract
- **Variation Margin**
 - market really bad
- **Cover daily market movements**
 - you SELL futures contract
 - price up (you get margin)
 - price down (you pay margin)

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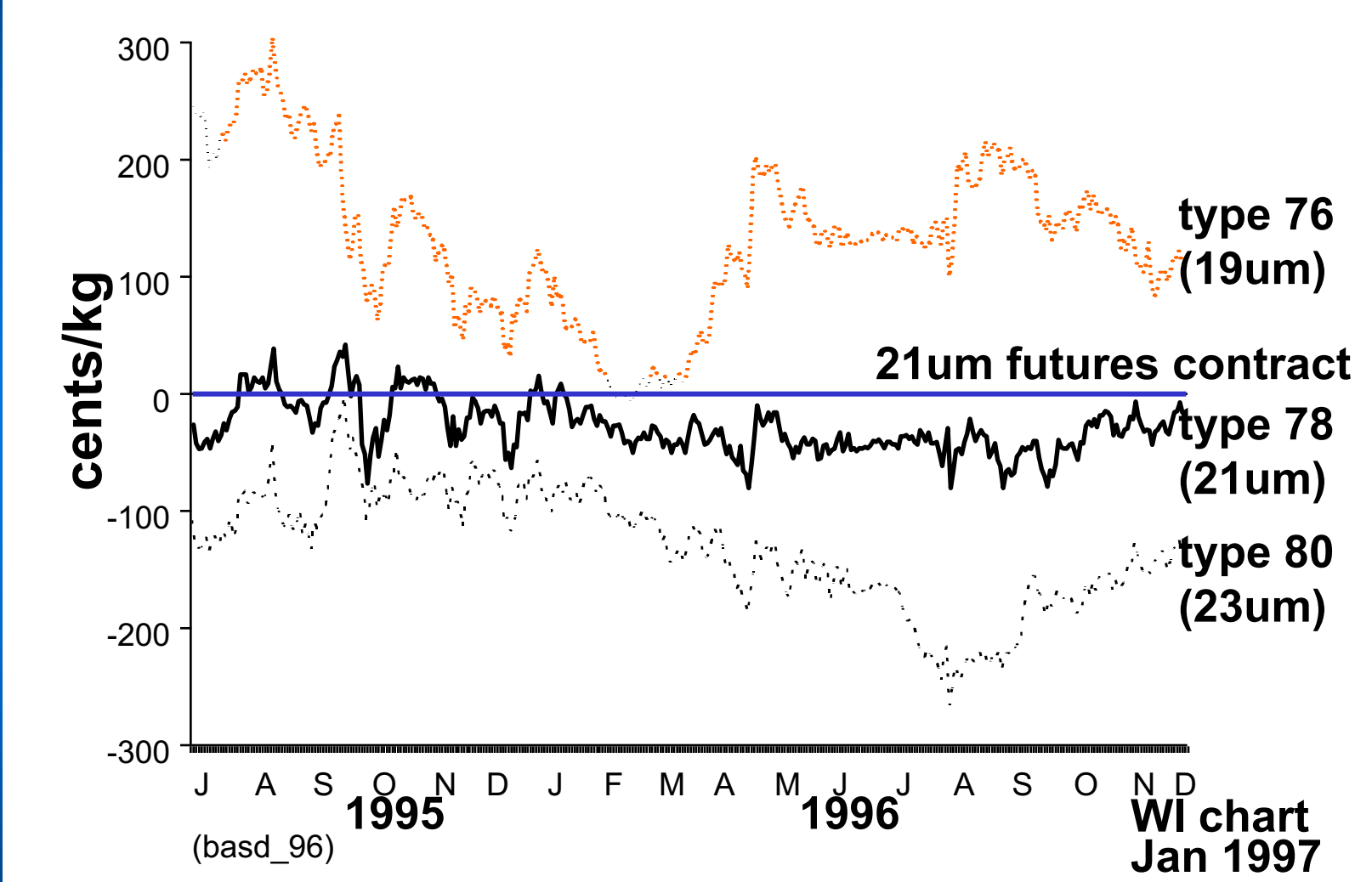
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Basis Risk



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Stepping Through Wool Futures

- 1. Talk to your bank**
 - you intend to manage risk NOT speculate
- 2. Select broker and open futures account**
- 3. Deposit money with futures broker**
 - cover margin calls
- 4. Identify contract month and number of contracts**
 - settle month AFTER physical sale

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Stepping Through Wool Futures

5. Place and complete order

- broker to confirm trade

6. Monitor position

- margin call financing

7. Close position

- buy futures
- delivery (21 μ m ONLY)

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Issues: SFE Futures

- **Margin calls**
 - finance
- **Basis risk**
 - 19 & 23 μm contracts introduced
- **Lack of Flexibility**
 - only certain months of the year
 - set quantities

There has to a simpler way!



Macquarie Wool Futures

- Micron Category, 19 to 25 μm , based on MPG
- Quality
- 2,000 clean kg minimum
- Length of contract
 - determined by the grower
- No margin calls
 - covered by bank guarantee.

Over-the-Counter

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Example - Cash price falls

A woolgrower produces 22 μm fleece wool. Shears in 2 months and sells in 3 months

	Physical	Futures
Now	<ul style="list-style-type: none">• Intends to sell wool in 3 months• 22 MPG currently 630 cents/kg	<ul style="list-style-type: none">• Sells 22 MPG for 610 cents/kg
+3 mths	<ul style="list-style-type: none">• Sells wool for 550 cents/kg	<ul style="list-style-type: none">• MPG currently 530 cents/kg• Profit $610 - 530 = 80$ cents/kg

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Example - Cash price rises

A woolgrower produces 22 μ m fleece wool. Shears in 2 months and sells in 3 months

	Physical	Futures
Now	<ul style="list-style-type: none">• Intends to sell wool in 3 months• 22 MPG currently 630 cents/kg	<ul style="list-style-type: none">• Sells 22 MPG for 610 cents/kg
+3 mths	<ul style="list-style-type: none">• Sells wool for 710 cents/kg	<ul style="list-style-type: none">• MPG currently 700 cents/kg• $610 - 700 = -90$ cents/kg

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