CRC

for

Premium

Quality

Wool

Price Risk Management Strategies

Produced for the CRC for Premium Quality Wool undergraduate program by;
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Situation 1

- It is 9 months to shearing;
- 21 micron market been trending down for 6 months;
- Woolgrower must achieve at least current market prices.

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Situation 2

- It is 6 months to shearing;
- 21 micron market has just hit a 6 year high;
- Economic conditions are reasonable with commodity prices in general displaying an upward trend;
- Woolgrower must achieve an average price no more than 100 cents below current market prices.

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Situation 3

- It is three months to shearing
- General market prices have been trending up for 17 months
- 19 micron market has fallen for the last 3 weeks closing the 19 to 21 micron premium to below average margins
- Woolgrower would like to achieve around current prices
- 3 month out exchange traded 21 micron futures are at a slight discount (10 cents) to the cash market, whilst OTC futures are at a 30 cent discount to the current market.

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Situation 4

- It is 6 months to shearing
- Woolgrower has had a good grain harvest which has covered all farm expenses for the year
- The market has been trending up for the last 3 months coming off a record low.

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Situation 5

- Woolgrower has wool in store and requires cash
- The market is trending up and economic conditions in the major consuming countries is rising.

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Situation 6

- The bank manager is subtlety suggesting to the woolgrower that he should lock in some price protection, using a forward contract, at current levels for wool to be shorn in three months
- The woolgrower does not want to miss out in possible price rises, especially the “price spike’ that is widely tipped to occur in 3 to 4 months time.

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Situation 7

- Time is NOW. What should you do for your clip?
- What will you do?

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STRATEGY SLIDES

- The following slides include suggestions for dealing with the scenarios preceding

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Situation 1 - Strategy

- *It is 9 months to shearing;*
- *21 micron market been trending down for 6 months;*
- *Woolgrower must achieve at least current market prices*.

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Strategy

1 <u>Sell futures</u> either SFE or Macquarie, depending on:
  - premium or discounts of the futures contracts to cash,
  - ability to get "set".

2 Take out <u>forward contract</u> taking into account seasonal conditions

3 <u>Sell</u> any physical wool currently holding

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Situation 2 - Strategies

- *It is 6 months to shearing;*
- *21 micron market has just hit a 6 year high;*
- *Economic conditions are reasonable with commodity prices in general displaying an upward trend;*
- *Woolgrower must achieve an average price no more than 100 cents below current market prices.*

Strategy 1

- <u>Buy put option</u> at 100 cents below current market, premium would be about 4% to 5% of current market prices.

Strategy 2

- <u>Sell futures</u> into rising market, scale up;
- <u>Forward contract</u> at market. Attach a <u>call option</u> 100 above current prices, to benefit from rising prices.

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Situation 2 - Strategies (cont.)

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Strategy 3

- Aggressive attitude
  - Closely monitor market and have sell order for futures in market at say 50 below previous days closing market prices. Sell order must be relayed to your broker daily. Be ready to move quickly. The danger, if market comes off quickly, is that you might not get set, i.e. prices fall through your level and you can't get set at levels you desire.

Situation 3 - Strategy

- *It is three months to shearing*
- *General market prices have been trending up for 17 months*
- *19 micron market has fallen for the last 3 weeks closing the 19 to 21 micron premium to below average margins*
- *Woolgrower would like to achieve around current prices*
- *3 month out exchange traded 21 micron futures are at a slight discount (10 cents) to the cash market, whilst OTC futures are at a 30 cent discount to the current market.*

Strategy

- **Sell, sell sell at least a portion. Sell into market, if trend continues up keep on selling portion. Consider setting prices for following clips as well.**
- **Be in a position to sell majority of clip quickly should trend change direction and head south. Must monitor closely.**
- **Use forward contracts or futures (preferably SFE or Macquarie)**

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Situation 4 - Strategy

- *It is 6 months to shearing*
- *Woolgrower has had a good grain harvest which has covered all farm expenses for the year*
- *The market has been trending up for the last 3 months coming off a record low.*

Strategy

- Closely monitor market on daily basis. Be in position to act quickly
- Have sell order in market if market turns, say at 50 below close of previous day

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Situation 5 - Strategy

- *Woolgrower has wool in store and requires cash*
- *The market is trending up and economic conditions in the major consuming countries is rising.*

Strategy

- **Sell wool for cash and buy futures, SFE or Macquarie**

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Situation 6 - Strategy

- *The bank manager is subtlety suggesting to the woolgrower that he should lock in some price protection, using a forward contract, at current levels for wool to be shorn in three months*
- *The woolgrower does not want to miss out in possible price rises, especially the “price spike’ that is widely tipped to occur in 3 to 4 months time.*

Strategy

- Forward contract for physical wool
- Buy call options at 100 over current market for 4% to 5% to take benefit of possible price rise. Financial outlay known (cost of premium).
- (Buying futures may require margin calls & if bank manager is putting on the pressure then this would not be a suitable strategy to use.)

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