"Hedging" Grain Facilitates Marketing

Sale of Wheat Futures by Farmer and Again by Elevator Company Enables Farmer to Realize on Crop at Once—Millers Buy in Advance, Protecting Themselves on Flour Contracts—Speculator, who Alone Risks Uncertainty of Market, Balances Supply and Demand

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GRAIN exchanges and their methods of doing business are little understood by the average business man not in the grain business. They should be. Grain is our basic industry and affects every business institution in Canada, both large and small. Close to one billion dollars will be brought into circulation by the sale of agricultural products grown in western Canada this year.

The important matter of hedging grain (you might know it by the name of futures or options) is a mystery to many and little understood. Ignorance makes the business man unappreciative; in fact, the reverse is often the case. You hear men on the street refer to grain exchanges as gambling holes and dens of thieves, and yet the business of these men would materially suffer if the grain exchanges and the machinery of the grain trade were withdrawn from the market.

Hedging Avoids Speculation

Curiously enough, while hedging is sometimes designated speculation by the uninformed, it is primarly used to avoid speculation. This is the fundamental reason for the hedging market. Banks lend money to any person, firm or corporation in the grain business only on the understanding that all purchases or sales of grain or flour are properly hedged. This is the bank's insurance against violent price fluctuations, and make more safe the credit granted.

First of all let us clearly understand the word hedging and its relation to futures and options. Hedging grain in simple language means matching a purchase with a sale or vice versa. A person who owns grain sells it on the exchange for future delivery, specifying some particular month. That is where the term "futures" is injected and the only "option" in the transaction is that the seller of the grain for future delivery has the option of delivering the grain on any day during the specific month; either the first day or the last day.

Speculator Balances Market

There are two main classes who take advantage of the hedging market. These are (a) sellers—farmers, country elevators, etc., and (b) buyers—millers and exporters.

It stands to reason that the trade of these two large bodies cannot always balance daily. There are not always sufficient buyers, neither are there always sufficient sellers. The result is the injection of a third party—the professional speculator who provides the balance wheel for the whole.

To make hedging operations more intelligent to the readers who are not in the grain business, we will give concrete examples.

Sells at Once to Avoid Risk

Jones owns 50 country elevators and in each one he has a competent manager buying grain from the farmers. Probably during a busy day in October 50,000 bushels of grain will be purchased in these elevators. Mr. Jones now owns the grain but he will not be able to sell it until it has been graded in Winnipeg and weighed at Fort William. He doesn't know when cars will be obtainable to ship the grain out, neither does he know whether the price will be maintained or whether it will fluctuate up or down. He, therefore, orders his manager to sell 50,000 bushels for December delivery, feeling sure the grain will have gone forward by that time. He knows what he paid for the grain; he knows what he sold it for, and what is the best of all, he knows what he has made on the transaction.

Best System for Farmer

It will be seen at a glance that the privilege of hedging grain permits the grain dealer to pay the producer the best possible market price. A little thought on the part of the reader will substantiate this. If hedging was not permitted or no facilities were provided, the country elevator operator would have to protect himself against delays in transportation by taking from the current cash price a sufficient margin to recoup him against any fluctuations that might arise in price. In this case the farmer would receive less for his produce and the country elevator operator would in time undoubtedly be a business failure. With the hedging facilities provided, and with such a wonderful system of telegraphs and telephones, the farmer is enabled to secure for his grain the highest market price on the basis of Fort William, less, of course, freight charges, etc.

Miller Buys for Future Delivery

The question might now be asked—"To whom does the country elevator operator sell his wheat for future delivery?" The answer is to the miller, exporter or speculator. The miller might have sold a large quantity of flour on contract for future delivery, he wants to make sure that he can secure the wheat at a price low enough to give him a profit, so he goes into the hedging market and buys wheat for future delivery. He then knows what the wheat is going to cost him when delivered. If he is a good miller he knows exactly what it is going to cost to grind the wheat into flour, and he knows what he can sell the flour for at some future date. The same procedure takes place when the exporter has an order from overseas. If he was not able to buy grain for future delivery the export business of grain in Canada would drop to a minimum. Transportation and finances would be seriously tied up and our whole marketing system would suffer.

Speculative Element

The third class who operate in a hedging market are the speculators. The work of these speculators is misunderstood and no doubt the public opinion in regard to futures is based on the work of this class of trader.

As stated herein before it stands to reason that the millers and exporters do not want from day to day all the hedging trades that are available. They only go into the market as the demand for the products milled or handled by them warrant. It will, therefore, be seen that there must be, of necessity, a third party who is always willing to step into the breach to take the trades as they come into the market from day to day. If the third party did not exist the constant market would not be present. The work of the speculator serves a useful purpose in this way: that is, by their willingness from day to day to either buy or sell at any time. They utilize the market facilities and permit the owners of country elevators to buy grain on any day of the week from the producers. The economic value of the hedging market would be seriously impaired if the country elevators could not make rapid trades from day to day. The speculator is the man who permits this to be done.

It requires a separate article to give the reader full information about the theory, benefits and evils of speculation. It is an economic subject of vital importance.

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