Southern Cotton Growers, Inc.
REPRESENTING COTTON PRODUCERS THROUGHOUT ALABAMA, FLORIDA, GEORGIA, NORTH CAROLINA, SOUTH CAROLINA AND VIRGINIA

COTTON MARKETING NEWS

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2005 Crop Strategies To Consider

December continues to trek upward. I have received increasing calls in recent weeks concerning the outlook and strategies on marketing the 2005 crop. In my last issue of this newsletter on 2/25/05 I discussed the market situation and outlook… so, we don't need to plow that ground again.

I can only conclude that the market is convinced of (1) sharply lower US and world production in 2005 and (2) continued strong foreign mill demand. As a result, new crop (Dec) prices have increased about 9 cents per pound since early-mid February. As I stated earlier, if in fact these expectations come to past, the market has headed in the right direction and is justified at these levels. But the conservative, cautious side of me can't help but wonder if and when the hammer is going to drop. *I'm not saying that it will, I'm just increasingly wary*.

There's also another angle to consider. For those thinking these prices will be sustained or move even higher, could this attract more acreage? Could it cause even a small set back in demand? If so, what direction might prices take then?

In an export-driven market (like cotton has become in recent years), wide price swings are possible and should be expected. Therefore, marketing strategies to consider should be aimed at risk management (i.e. taking profit when offered and reducing risk to a more manageable level). Also, increasingly, strategies need to be flexible. But this is tough decision-making and can often be frustrating.

In the following table, I attempt to layout and compare several alternate strategies that might be considered at this point in time. Keep in mind, there are other tools/strategies also and a word of caution— read the numbers carefully and understand the simplifying assumptions made. I don't lay claim to the idea that this is a perfect approach, but rather I'm just trying to help us all think through what the alternatives and decisions are and what the implications might be.

There are 5 strategies *based on where December futures are at present (about 58 cents)*. These strategies are: **Do Nothing** (wait and take any LDP at harvest plus whatever the market offers at that time), **Contract** (fix a price of 55 cents based on where the market is now and then take any LDP at harvest time), **Put Option** (purchase a Put at where Dec is now, take any LDP and sell at harvest), **Contract+Call** (contract as described plus buy a Call at where Dec is now), **Contract+Call*** (contract as described, but wait and buy the Call when the market falls to the level shown below current Dec.

The table shows the total money received based on the price outlook (price at the time) including LDP and Option value minus premium if applicable. The Put or Call premium is assumed to be 3 cents (300) and the Cash Price – AWP spread 7.5 cents (750). Basis for cash sale is assumed to be 3 cents. For illustration purposes, prices of 46 to 64 cents are used.

	Price Outlook									
	4600	**4800**	**5000**	**5200**	**5400**	**5600**	**5800**	**6000**	**6200**	**6400**
Do Nothing	5950	5950	5950	5950	5950	5950	5950	5950	5950	6100
Contract	7150	6950	6750	6550	6350	6150	5950	5750	5550	5500
Put Option	6850	6650	6450	6250	6050	5850	5650	5650	5650	5800
Contract+Call	6850	6650	6450	6250	6050	5850	5650	5650	5650	5800
Contract+Call*	8050	7650	7250	6850	6450	6050	5850	5850	5850	6000

In summary, let me see if I can decipher the numbers.

First of all, the price (total money) from simply doing nothing is 59 to 60 cents. So for no effort and little risk, you get 59 to 60 cents and you can use this as a basis for comparing everything else.

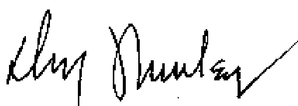
If you contract and the market goes down, you benefit from both a good contract and a good LDP. Total money looks good and you are happy. If, however, the price goes up-- well, you're not happy because your LDP has declined with the price fixed. But, if this is a risk you think is worth taking, you could end up considerably better than the do nothing strategy.

Instead of contracting, a Put Option will allow you the opportunity to profit from the Put if the market declines but, because price is not fixed as with a contract, actually sell the cotton at a higher price if the market goes up and, therefore, offsetting what otherwise would be a decline in LDP. Now, because of the premium paid, you're potentially not going to take home as much as with the contract if the market goes down, but you could be better off if the market moves up.

Another strategy would be to contract and buy a Call to protect you from the market moving up (protect against the possibility of a declining LDP). Based on the assumptions I've made, the numbers would come out the same as using a Put.

Another version of this would be to contract at the current market, wait for the market to decline, and if it does then purchase the Call. For example, as the table shows, if contracting now and purchasing the Call when and if the market declined to 46 cents, and then if the market later returned to current or higher levels, total money would be 80.5 cents. This approach, if the market played out that way, would provide the highest money if the market declines and better than or about equivalent to any of the other strategies if the market remained at current levels or moved higher.

In summary, for producers willing and able to use Options to provide some flexibility, taking protection at current market levels appears to be a reasonable approach and provides an opportunity to do better than the do nothing approach. For producers not yet comfortable with Options, contracting at current levels would be better than doing nothing if the market declines. The difference in total money could be 10 cents per pound or more. But in exchange, you'd have to be willing to risk less money if the market moves higher.



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