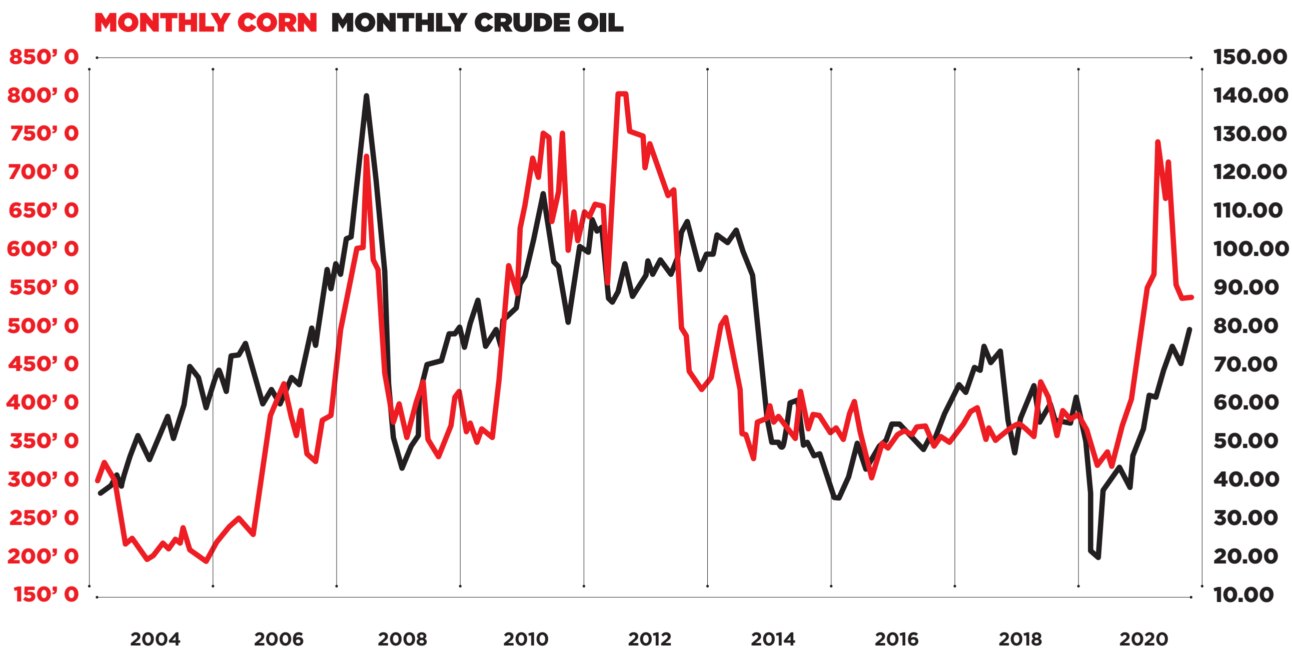


ENERGY PRICES TURN SHARPLY HIGHER

Surging input costs squeeze farm profits.

In the monthly continuation chart of nearby crude oil futures (in black) and corn futures (in red), you can see the close correlation between crude oil and corn prices. In the rally to the high in 2008, crude oil rallied earlier and further than the corn market. In 2012 and in 2020-2021, corn futures went up further and faster than the crude oil market. We made the recommendation to buy 2022 fuel and fertilizer in August 2021 and at the same time hedged 20% of the new-crop corn. The price of fertilizer was at very high historic price levels, but the corn-to-fertilizer ratio worked.

By Al Kluis

This fall after harvest wrapped up, a longtime customer from Iowa called and told me he was working on his budget for next year.

"My breakeven for corn has jumped to $5.00 per bushel," he said. "Is that higher than most of your customers?"

Every day, I study and chart the price of grain and energy. After the April 2020 COVID-19 lows, I watched the grain markets — and the price of crude oil, gasoline, natural gas, and ethanol — move sharply higher. I was amazed at how ethanol margins stayed positive as corn surged from $3.50 per bushel to over $7.00 per bushel. Many days and weeks, ethanol prices went up faster than the corn market.

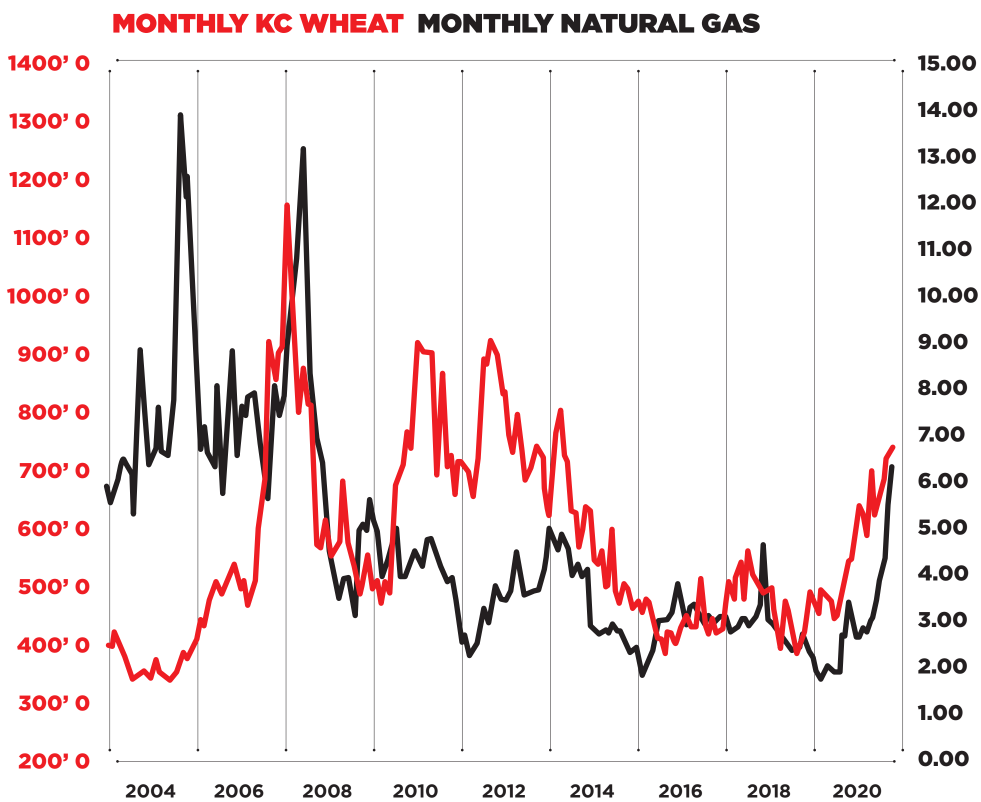
However, I became more and more concerned that the sharp rally in the price of crude oil and natural gas would increase fuel and fertilizer costs in 2022. When I looked at the large discount of the December 2022 corn to the December 2021 corn, and the discount of new-crop wheat futures, I saw that margins for grain farming would be tight in 2022. When I am making new-crop grain marketing recommendations, I am not trying to pick the top. Instead, I look at the new-crop hedge as a spreadsheet decision. Can we lock in inputs and hedge the crop ahead to lock in a profit? Both actions have to be taken at the same time. When I made input recommendations to lock in fuel and fertilizer (as I did in early August for the 2022 crop), I also made hedge recommendations for up to 20% of the 2022 crop — corn, soybeans, and wheat. I did not think the global price of fertilizer would come down, and the weekly crude oil chart looked like it was heading to over $80 per barrel.

How should you handle your marketing in this new higher-cost environment? Here are three suggestions:

1. Work closely with your suppliers. The farm retailers that sell fuel, fertilizer, and your other inputs all work on tight margins in a very competitive market. Try taking a long-term team approach. If you can work with your retailers to get the right product purchased at the right time, and get it to the right location, then you greatly increase your chance of making the right decisions.

2. Meet with the landowners to show them your margins. Show them that

Chart Source: DTN ProphetX



The monthly continuation chart of nearby natural gas (in black) and CBOT wheat futures (in red) shows a strong (but not perfect) correlation over the past 16 years. The natural gas and wheat markets peaked in 2008, and turned lower into early 2012. Both put in important COVID-19 lows in April 2020. From there, wheat prices rallied further and faster than the natural gas market. In August we made the recommendation to purchase your 2022 fuel and fertilizer. The price of fertilizer was high, but the number of bushels of new-crop wheat it took to pay for the fuel and fertilizer was at a good historic ratio.

new-crop 2022 corn, soybeans, and wheat are trading at a large discount to where the grain markets rallied last summer. The odds are you are going to pay more rent next year. Try to set up a flex lease that pays a fixed amount per acre plus, if your total revenue exceeds a certain dollar amount, a percentage of that revenue to the landowner. Again, think of this as a team effort. Try to create a win-win contract.

3. When you are making new-crop pricing decisions, use all the marketing alternatives available. Last year, farmers who had a combination of hedges and puts came out better than farmers who only used cash contracts or hedges. The put options became worthless, but the loss on the put was minimal compared to the increased value of your new-crop corn and soybeans.

What is the game plan for the balance of your 2021 crop and getting some of the 2022 crop hedged? I am a seasonal seller with additional cash sales planned between May and July 2022. I would consider sales in February and March if a weather scare develops in South America and prices rally back to within 5% to 10% of the 2021 highs.

Remember that March is a critical change-of-trend month. If prices rally into March, then it is usually a good time to sell. If corn and soybean prices correct down into the month of March, then it sets up a good time to buy. At this time, the weather forecasts for South America suggest a trend line or better crop. The odds are good that I will be making cash and new-crop sales between May and July.

Here are four key weeks I will be watching next year:

- **Week ending May 13**
- **Week ending May 27**
- **Week ending June 24**
- **Week ending July 8**

These are important change-of-trend weeks. If the corn and soybean markets rally into those weeks, and the news is bullish, then stay disciplined and make a series of cash sales. For new-crop 2022 sales, those are key weeks when I will do a series of 10% hedges. I will also be buying put options. SF

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Chart Source: DTN ProphetX