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Webb, Jean A. COMMENT

From: secretary
Sent: Monday, July 31, 2000 8:18 AM
To: Webb, Jean A.; Colbert, Edward W.
Subject: FW: Grain futures train wreck comming. An extreme Ag article you must heed.

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-----Original Message-----
From: Vince [mailto:jvmoye@staroute.com]
Sent: Saturday, July 29, 2000 8:36 AM
To: secretary@cftc.gov
Subject: Grain futures train wreck comming. An extreme Ag article you must heed.

The below clip from an article in "extremeag.com" is included below. I fully agree with the article's reasoning and hop that you will take action to prevent a cash grain market crash by following their advice.
Best regards,
Vincent Moye jvmoye@staroute.com
1022 i Ave
Reinbeck, IA

A bedrock proof of "valid" futures markets as a risk management tool is the convergence of cash bids (for grain in deliverable position) and nearby futures during the delivery period. If markets are working properly, arbitrage will occur if cash bids for grain in deliverable position are below the board because a trader can theoretically buy the cash commodity and immediately sell it on the Board at a profit because it's already in a deliverable position. There are no transportation costs involved. Conversely, should cash grain in deliverable position be priced at a premium to futures during the delivery period, arbitragers could be expected to buy the nearby futures contract and immediately serve notice of intent to deliver, thus bringing about "convergence" between cash and futures from that situation as well.

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But if this convergence fails to occur, it is proof positive that something is wrong with the delivery system. And an alert Bare Knuckles reader has pointed out to me that convergence failed to occur for the March and May corn contracts and now for the expiring July contract as well. He believes the problem lies in inadequate daily storage charges allowed for elevators licensed to hold deliverable stocks. And since this also determines what is considered "full carry" in futures markets, it also impacts on the willingness of producers to store on the farm as well. The result is an excess of cash sales pressure vis a vis the futures market (widening basis) which provides a windfall opportunity to the buyers of the world but throws salt in the wound of low prices for producers who must sell old crop to make room for new crop.

Last January a host of new delivery points for corn were approved along the Illinois river. The objective was to make futures more appealing to producers by offering delivery locations well beyond the Chicago and Toledo delivery points that have been in place for years. And while it has improved their usefulness somewhat, my source reports there is still inadequate incentive for cash merchandisers to store current surplus. The CBOT storage charge allowed at present is just 4.5 cents per bu. per month, versus the "spot market" storage rate of 5.25 cents per month due to the high demand for storage. And in the futures market, the current spread between December and July futures is less than 27 cents, only 3.8 cents per month. If storage incentives aren't boosted right now, we could be headed for a basis wreck like we haven't seen since the spring of '96. Only that time it was futures racing higher, outdistancing cash. This time it will be cash collapsing faster than futures.

My source says the CBOT should increase storage payments to about 6 cents per bushel per month to jumpstart the futures market's vital function of bringing about convergence between cash and futures during delivery. This would also tend to widen carrying charges in the futures market and make it more worthwhile for producers to store surplus on their farms, easing pressure on basis as we brace to absorb a monster crop. He quotes the CBOT's own literature in justifying the additional delivery points for the Illinois Waterway Delivery System (IWDS): "Delivery systems in the futures markets exist to ensure (emphasis mine) convergence of cash and futures prices during the delivery month." And he warns that unless CBOT is willing to recognize this need, futures markets become far less attractive as hedging vehicles, particularly for farmers, during times of surplus.

CFTC needs to hear his plea, too. I intend to forward this to them and urge you to as well if you agree. You can contact them at this address: secretary@cftc.gov Back in May I raised a ruckus over CBOT plans to raise daily trading limits in the grains and asked Bare Knuckles fans to follow suit by voicing objections to the CFTC (Commodity Futures Trading Commission). I was greatly encouraged to read yesterday that of the nearly 120 briefs filed with the CFTC along with my own, every single one was in opposition! If you contributed to the cause, pat yourself on the back and then consider forwarding your thoughts on this storage premium problem as well. Don't waste your time petitioning the CBOT directly. They are dominated by the grain companies who just love it when the system gets "broke" and they get to acquire grain by the trainload and bargeload at firesale basis levels. It will take pressure by their regulatory watchdog to get results.