As published in

DairyAdvisor™

Risk Management

Curves ahead with MPP

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The New Year started out facing a headwind with milk prices sliding into the ditch. Nearby Class III and Class IV contracts put in fresh lows by mid month. The slide left many to wonder, "Where's the bottom?" The slope of the ditch conjured up memories of the debacle of 2009. Could it happen again?

Readers of this column should not have been taken by surprise, as the bearish growls had been heard around the world for some time. By mid January, temporary lows yielded to a sharp corrective rally, which perked attention across the industry. Many were able to convince themselves that the bull once again was on the move.

For the short term, maybe… After tugging us up the slope a bit, the bull has just been trotting in circles. What about the long term?

Let's look past the dust stirred up in short term. Let's look beyond the immediate ditch, toward the unknown horizon of 2015. What can or should you do?

The answer is simple: Manage your risk. Do you have – and are you implementing – a comprehensive risk management strategy?

In particular, is that strategy one that mechanically spits out a buy/sell recommendation depending on which side of the spectrum you're on? Or, is it a well-thought-out, methodical approach that incorporates some level of comfort?

Of course, new factors have come into play in the road ahead, including the new Farm Bill's Margin Protection Program (MPP) in which many have taken solace. Five years of debate among legislators in Washington, echoing their long-running political gridlock, nonetheless yielded an all-encompassing approach to mitigating risk and market volatility. MPP has even been touted as the long-awaited solution producers can now rely upon to ensure their margins, profitability, and solvency.

To some extent the hype may be true. MPP is the most progressive of the farm support type programs. But, like most things in life – especially those stewed in a political pressure cooker – the devil is in the details.

Without going into a complete breakdown here, one glaring aspect of the new program draws special cause for concern – the criteria for payout. The last thing the government wants to do is to make a payout based on a program designed to generate a revenue stream. The criteria to trigger a payout are very specific – a period of two consecutive months with margins below a certain threshold – which leaves me wondering how realistic that scenario will be.

Don't get me wrong here: MPP probably does serve as a suitable backstop for some level of coverage. For that we can applaud the folks who put it together. But MPP ought to serve as a complement to the dairy producer's comprehensive risk management plan that includes grains and livestock as well as available futures and options products that can consistently gain market share. MPP ought to work together with the risk management plan to serve their original purpose – to mitigate risk and manage price volatility – while offering a streamlined vehicle to secure a real margin and solvency year in and year out.

Your dairy vehicle can be the same sort that corn farmers, soybean farmers, cattle ranchers, and their brothers and sisters in other fields of American agriculture have been using for decades to manage risk and secure margins. While it took 20 years to build the dairy markets, you can drive on them today and maintain profitability no matter how the winds may blow and how slippery the road ahead may be.

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