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Selling Covered Puts on Soybeans¹

Dr. Barnaby,

I purchased and viewed the recorded webinar on crop insurance. I have purchase full RP for both corn and soybeans. I have begun to sell Dec puts to hedge the corn side. I wasn't clear from the presentation what the best solution is on the soybean side of things? I apologize if you already laid it out and I missed it somehow.

Thanks,

Corn/Bean Grower

Dear Grower

For example, a farmer with a 100,000 bushel soybean APH and 80% Revenue Protection (RP) coverage would generate an 80,000 bushels guarantee, 16 Yields Adjusted Asian puts, and 16 Yields Adjusted Asian calls. Assuming you are in a state with a RP soybean base price of \$13.49, then the effective strike price would be $80\% \times \$13.49 = \10.79 . At \$10.79 the deductible in RP would be zero and if yield is less than the APH yield, RP would make indemnity payments.

¹Prepared by G. A. (Art) Barnaby, Jr., Professor, Department of Agricultural Economics, K-State Research and Extension, Kansas State University, Manhattan, KS 66506, March 16, 2011, Phone 785-532-1515, e-mail – barnaby@ksu.edu.

You could sell a put as high as a \$11.40 strike price for 61 cents and be covered with insurance indemnities or production exceeding the APH, based on today's market.

The effective strike price is \$10.79 for 80% coverage RP on soybeans. Sell up to 1/3 of the Yield Adjusted Asian puts in RP on the CME, in this example 5 CME puts or less at strike price of \$11.40 or less.

Results from selling CME \$11.40 November put for 61 cents:

1. If fall price > \$11.40, CME put expires worthless.
2. If fall price < \$11.40; > \$10.79, the CME 61 cent put premium covers margin losses.
3. If fall price < \$10.79; the RP pays indemnity payments if yield is equal to APH yield or less, i.e. a zero deductible; or margin losses are coverage with production exceeding the APH.

You would have less risk if you sold \$10.80 puts for 41 cents but the returns are less. If you sell puts with a strike greater than \$10.80, then you are counting on the put premium to cover net margin losses because the RP with an average yield does not start covering margin losses until the price falls below \$10.79.

Note, if you purchased 85% RP soybean coverage, then your effective RP strike price is $85\% \times \$13.49 = \11.47 . However, if purchased 75% RP soybean coverage, then your effective RP strike price is $75\% \times \$13.49 = \10.12 . Therefore, higher RP coverages allow farmers to cover a higher strike price on put sales.

Thank you for participating in the webinar. If you have any additional questions please contact me.

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