

# ASX Grain Futures & Options

The difference between ASX and North American futures  
– an analysis for grain end users.



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# About ASX



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The ASX Limited group of companies, known as the Australian Securities Exchange (ASX), includes the combined operations of the Australian Stock Exchange and SFE Corporation (Sydney Futures Exchange) which merged in July 2006.

ASX operates Australia's major financial markets for equities and derivatives, and provides listing, trading, risk management, clearing, settlement, depository and market data services for domestic and global customers.

# What's the difference?

Contract Specifications	ASX	CBOT
Contract	Australian Milling Wheat	Wheat
Underlying Physical Grade	APW2	Soft Red Winter Wheat #2
Pricing Point	New South Wales Track (Newcastle & Port Kembla)	The Chicago Switching District, the Burns Harbor, Indiana Switching District or the Toledo, Ohio Switching District ...
Currency Quotation	Australian Dollars per tonne	United States Cents per bushel

Which contract more closely represents your physical exposure?

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ASX Grain Futures reflect local supply and demand  
– especially important during times such as drought.

# Why is the difference important?



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It is important to realise that different markets will behave differently.

Just like the famous Castrol “oils ain’t oils” advertisement, a hedge based on a North American market is not the same as a hedge based on ASX.

A hedge based on North American grain prices is not going to primarily reflect what is happening in your local market. A drought in Australia may be reflected in North American markets but not to the same extent as ASX.

If you are looking to protect your business from higher grain prices due to drought or like event then a hedge on ASX will provide more accurate protection than a hedge based on North American markets.

# Is there evidence?



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Following the drought in 2002, ASX realised the need for a domestic price risk management facility and established Grain Futures. Since inception in May 2003, there have been two seasons where the ASX price has performed quite differently to North American markets.

**Season 2005**

**Season 2006**

# Season 2005



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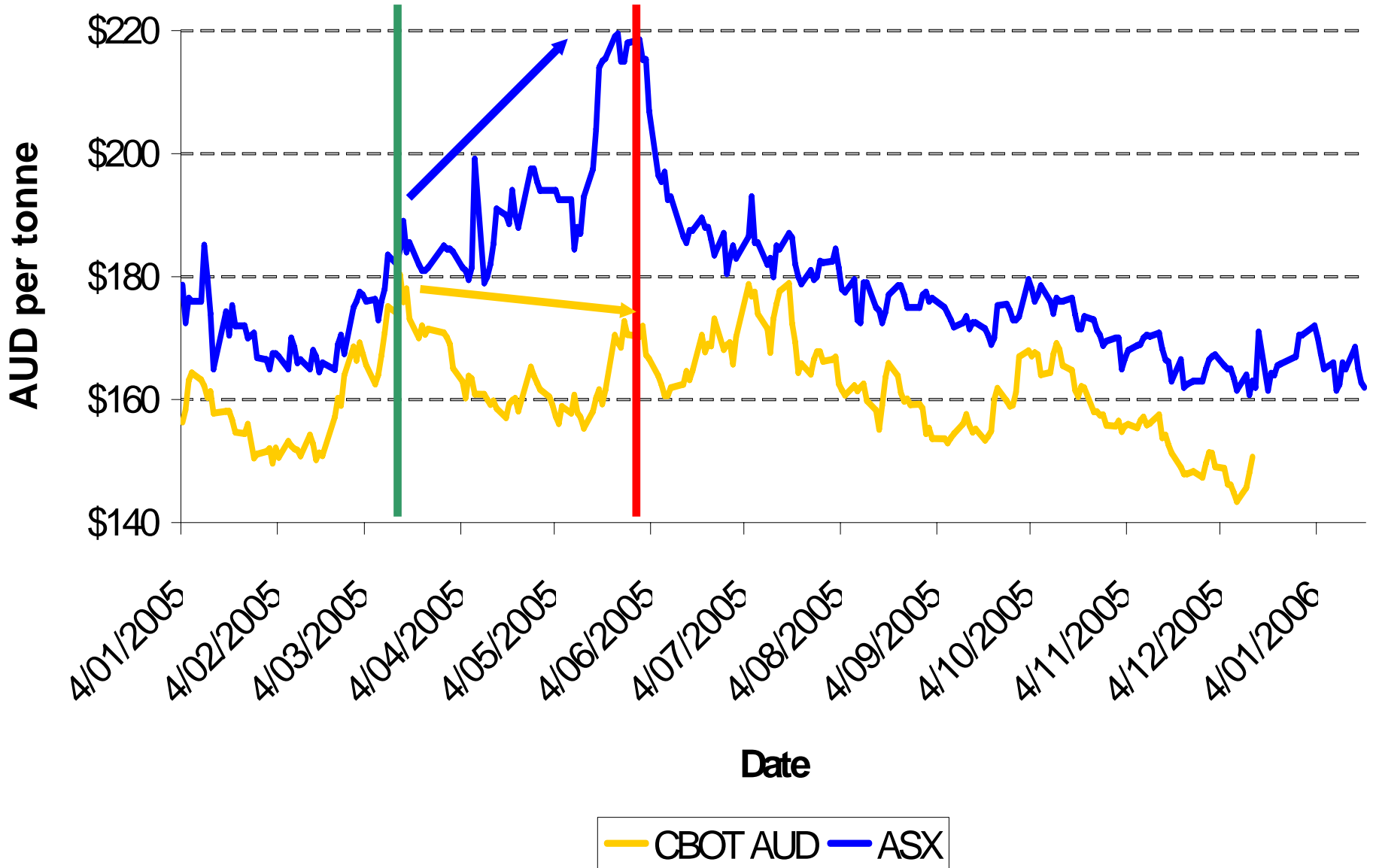
In 2005, there wasn't a drought but the season break for the winter crop was very late with rain only falling in the first half of June.

With memories of 2002/2003 still vivid, the market traded higher until it reached \$220 NSW Track. At this time, the AWB National Pool tender was trading at similar levels and was acting as an "Import Parity" figure. Like "Export Parity", "Import Parity" is also a moving target and is an estimate for the cost of importing grain in to a region. Had there not been a break and the market traded higher, actual "Import Parity" was estimated to be in the vicinity of \$250-\$260 landed NSW Port which up-country values were expected to exceed.

The following chart highlights the divergence in wheat prices in 2005 between 15<sup>th</sup> March (green line) and 31<sup>st</sup> May (red line). While the Australian crop was waiting for sowing rain the US crop was experiencing favourable conditions. ASX and CBOT prices were trading in different directions.

# Wheat Prices for Season 2005

ASX January 2006 Wheat vs US Wheat (Chicago Dec 05) in AUD/tonne



# 2005 Explained



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The divergence in the ASX and CBOT wheat prices provides an example of how markets based on a similar underlying commodity can trade quite differently due to fundamental factors. The difference between the two markets peaked on the 19<sup>th</sup> May 2005 and was worth approximately \$55 per tonne.

The following table demonstrates the impact such divergence can have on a hedge placed on ASX and a hedge placed on CBOT. The physical price of wheat on the 31<sup>st</sup> May was assumed to be \$220.

A bought hedge on CBOT would have actually cost \$10 per tonne which is added to the physical cost, resulting in a total cost of \$230.

A bought hedge on ASX, over the same period of time, returned \$34 per tonne which is deducted from the physical cost, resulting in a total cost of \$186. The ASX hedge outperformed the CBOT hedge by \$44 per tonne.

# Hedge Performance 2005

Exchange	15 <sup>th</sup> Mar 2005	31 <sup>st</sup> May 2005	Hedge Return	Physical Market
	<b>Bought Futures</b>	<b>Sold Futures</b>		\$220 (assumed price)
<b>ASX</b> AWM7F	\$184.50	\$218.50	\$34 (\$218.50 - \$184.50)	\$186 (\$220 - \$34)
<b>CBOT</b> WZ6	\$180	\$170	Loss \$10 (\$170 - \$180)	\$230 (\$220 - -\$10)

# Season 2006



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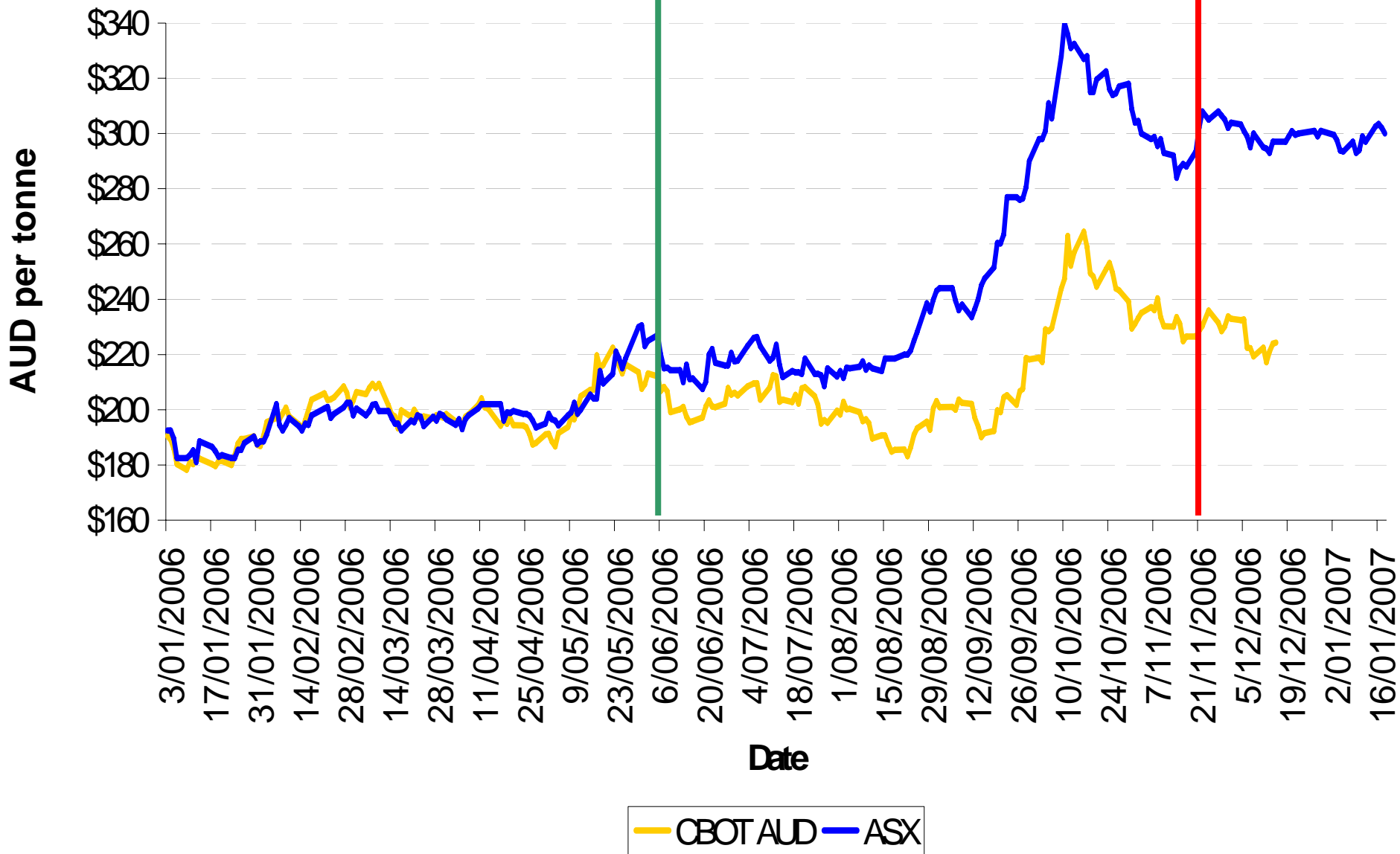
In 2006, Australia was again in the grip of another widespread drought. The winter break was very poor and follow up rain extremely patchy. The Australian grain market traded towards “Import Parity” and the correlation with North American prices was lost. ASX reflected this reality.

Like the drought market in 2002, domestic grain prices traded much higher than North American futures. Domestic grain prices peaked in early October and then traded lower as harvest commenced.

The following chart and table highlight the different performance of ASX compared with CBOT using a hypothetical hedge that was in place from the 6<sup>th</sup> June 2006 (green line) and closed on the 22<sup>nd</sup> November 2006 (red line).

# Wheat Prices for Season 2006

## ASX January 2007 Wheat vs US Wheat (Chicago Dec 06) in AUD/tonne



# 2006 Explained



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Between June and November, the Australian crop struggled through drought. CBOT reflected this reality but not to the same extent as ASX. As a result, the prices on the two markets traded at significantly different levels. Prices on the 10<sup>th</sup> October 2006 suggest a peak in the difference was in the vicinity of \$90 per tonne.

Once again, the difference in price behaviour is an example of how markets based on a similar underlying commodity can trade quite differently due to fundamental factors.

The following table demonstrates the financial returns of a hedge on ASX versus a hedge placed on CBOT. The physical price of wheat on the 22<sup>nd</sup> Nov was assumed to be \$310. In this hedge example it is shown that a hedge on ASX outperformed a CBOT hedge by \$60 per tonne.

# Hedge Performance 2006

Exchange	6 <sup>th</sup> June 2006	22 <sup>nd</sup> Nov 2006	Hedge Return	Physical Market
	<b>Bought Futures</b>	<b>Sold Futures</b>		\$310 (assumed price)
<b>ASX</b> AWM7F	\$220	\$302	\$82 (\$302 - \$220)	\$228 (\$310 - \$82)
<b>CBOT</b> WZ6	\$207	\$229	\$22 (\$229 - \$207)	\$288 (\$310 - \$22)

# Further information



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