Hedge Effectiveness of Texas Live Cattle

Wesley S.Regmund, Charles C. Martinez, Justin R. Benavidez, and David P. Anderson

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Abstract

The greatest risk typically facing the fed cattle industry is price risk. In order to mitigate output price risk, producers look to hedging in the futures market. Hedges can effectively reduce price and revenue risk, although basis risk remains. Hedging becomes particularly important in the fed cattle industry because fed cattle are ‘non-storable’ both in a definition’s sense, and a literal sense. This study compared several theoretical hedging options using Texas cattle prices, over the July 2010-November 2015 period to determine which hedge provides the most price protection. Additionally, the effects of different hedge lengths with regard to net price were estimated.

Methods

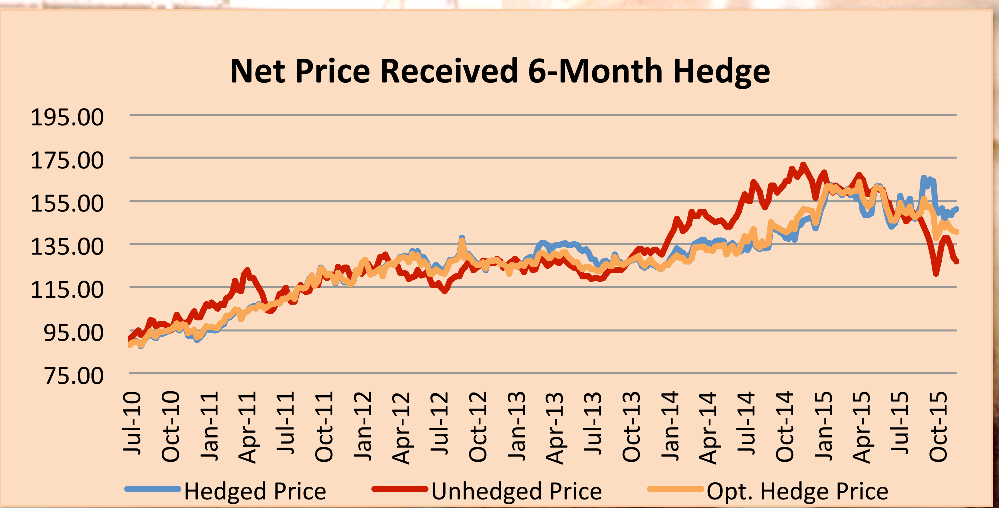
Anticipatory hedges were placed on cattle ranging from six months to two months before their expected sale date. Gains or losses were calculated and combined with the actual cash price and net prices received were determined.

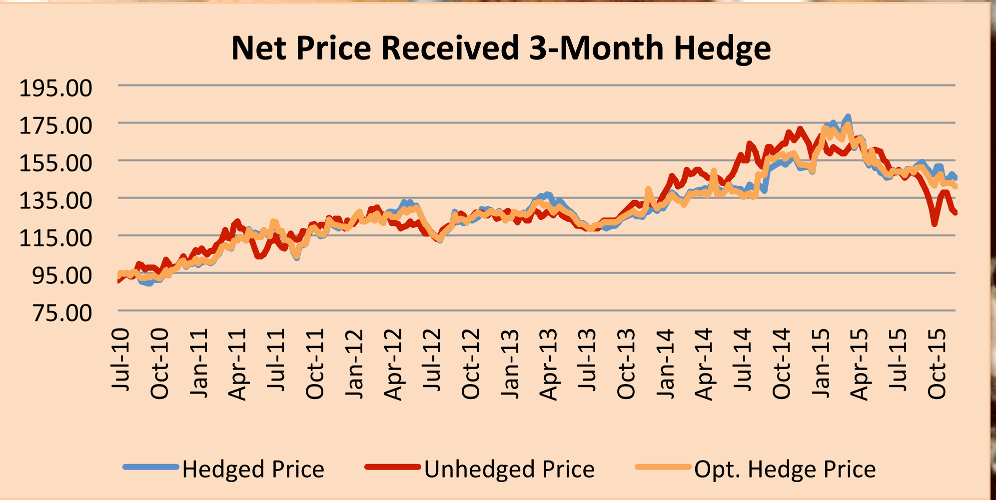
Conclusions

Results show that the hedge resulted in a loss slightly below 60% of the time with the average loss declining as the length of the hedge is reduced. This shows that while protecting downside risk is needed, a more selective hedging approach may produce higher returns. This method however does not take into account the value of minimizing price variability that hedging provides

Data

Courtesy of the Livestock Marketing Information Center (LMIC)





Probability of Net Price Increase from Hedge ($/cwt)

	2 Mo	3 Mo	4 Mo	5 mo	6 Mo
Prob. Gain > 0	43.27%	40.00%	43.27%	44.00%	40.36%
Avg Gain/Loss Hedge	-0.74	-1.06	-1.38	-1.72	-2.52