Price risk management: What to expect
Performance of Market Advisory Firms

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This is the third of a five part series on managing price (marketing) risk. The first fact sheet (F-589) presented the fact that few, if any, people can predict prices. Prices cannot be predicted because the market uses all available information to determine price. What makes today's price different from yesterday's price is "new information." If this "Efficient Market" hypothesis is correct, then one marketing strategy is nearly as good as any other marketing strategy. What is important is that producers develop "rules" for marketing.

Fact sheet two (F-590) reported on research conducted at Kansas State University by Drs. Terry Kastens and Kevin Dhuyvetter. They used records from over 1,000 Kansas farms during a 10-year period to evaluate management practices that explained the difference between the top one-third of the farms and the bottom one-third of the farms. Their conclusion was that price (marketing strategy) made little or no difference in the profitability of the farms. Important management factors were costs, yields, and use of technology.

This fact sheet reports on research findings from the University of Illinois. The research showed that a naïve marketing strategy for wheat beat the average of market advisors. Advisory services recommendations for corn were nearly equal to a naïve strategy and the recommendations for soybeans were better than the naïve strategy.

Performance of market advisory firms

Scott Irwin, Darrel Good, and Joao Martines-Filho manage the AgMAS (Agricultural Market Advisory Service) project at the University of Illinois, Urbana-Champaign. The objective of the project is to provide information about the performance "track record" of market advisory services and to assist farmers in identifying successful alternatives for marketing and price risk management. Access http://web.aces.uiuc.edu/farm.doc/agmas for project results.

Depending on the year, AgMAS subscribed to between 21 and 27 advisory newsletters. Subscriptions were received for the 1995 through 2000 marketing years for corn and soybeans and for the 1995 through 1999 marketing years for wheat.

Each newsletter's advice for marketing corn, soybeans, or wheat was used to calculate the average price per bushel a farmer would have received if the marketing advice was precisely followed. The calculated net price was the cash price plus or minus gains and losses due to recommended

futures and options transactions, plus market loan program benefits. Brokerage and storage costs were subtracted from the calculated price.

The calculated prices that would have been received if the newsletter advice were precisely followed were compared to three benchmark prices (24-month average price, 20-month average price, and a price determined from USDA projections). The 24-month average price is used as the benchmark price in this fact sheet. The 24-month benchmark was calculated by assuming that one bushel of corn, soybeans, or wheat was sold each day over a 24-month period and then the average price received per bushel was calculated. Storage and interest costs were subtracted from the prices.

Tables 1, 2, and 3 show the benchmark price, the calculated advisory services' average price, the number of advisory newsletters whose advice resulted in a net price above the benchmark price over the total number of newsletters for the year, and the gain or loss if a producer would have precisely followed the advisory service's advice. The last column shows the averages for the 17 firms that provided advice for all years in the study. Results are shown for the years 1995 through 1999 for wheat and 1995 through 2000 for corn and soybeans.

Wheat

In 1995, the market advisory services for wheat produced an 18¢ positive return compared to the benchmark (Table 1). For the years 1996 through 1999, the services' yearly average calculated price compared to the benchmark was -13¢, -59¢, -54¢, and a -4¢. The five-year average advisory service price was 21¢ per bushel less than the benchmark price.

During the five years, none of the 17 advisory firms that provided wheat market advice all five years had an average price above the benchmark price. The 17 firms' average price was 21¢ per bushel less than the average benchmark price. Note there were between 20 and 24 advisory firms each year, but only 17 firms provided marketing advice all five years.

Corn

The firms' performance was slightly better with corn and significantly better with soybeans. For corn (Table 2), the six-year average for the 17 firms that provided market advice all

six years was 0.7¢ per bushel above the benchmark. Seven of these 17 firms advice produced a six-year average price above the benchmark.

For the 1995 corn-marketing year, 18 of 25 market advisory services beat the benchmark price. The average of all 25 services was 13¢ above the benchmark. For the 1996, 1997, 1998 and 1999 crop marketing years, the advisory services performance was -2¢, -1¢, -7¢, and -3¢ compared to the benchmark. The services beat the benchmark price by 4¢ for the 2000 corn crop.

Soybeans

For soybeans (Table 3), the advisory firms beat the benchmark price five out of the six years and the average of the 17 firms that provided advice all six years beat the benchmark average price by 12¢ per bushel. Depending on the crop year, there were between 22 and 26 firms providing marketing advice.

The advisory firms' average price was 33¢ above the benchmark in 1995, 21¢ in 1996, 8¢ in 1997, 17¢ in 1999 and 3¢ in 2000. Only in 1997 was the benchmark higher than the advisory services' prices.

Conclusions

Results from this pricing performance study supports the efficient market theory hypothesis that "prices are determined by the market using all available relevant information" and that "prices cannot be predicted." If prices could be predicted, then advice from more of the advisory firms would have resulted in higher net prices than was obtained from following the naïve marketing strategy used to calculate the benchmark price more often.

Table 1. Pricing Performance Results, Wheat, 1995-1999.

	1995	1996	1997	1998	1999	'95-2000
Mkt. Benchmark[a]	$ 3.61	$ 3.95	$ 3.22	$ 2.90	$ 2.68	$ 3.27
Average of Services[b]	$ 3.79	$ 3.82	$ 2.63	$ 2.36	$ 2.64	$ 3.06
# Above Average[c]	14/24	9/23	4/20	1/21	5/23	0/17
Average Gain or Loss[d]	+18¢	−13¢	−59¢	−54¢	−4¢	−21¢

[a] 24-month average price, 12-months before and 12-months after harvest.

[b] Average price received if advisory services' advice was followed.

[c] Number of advisory services that provided a net price above benchmark price and the number of advisory services that gave advice.

[d] Benchmark price minus advisory services' average price.

Table 2. Pricing Performance Results, Corn, 1995-2000.

	1995	1996	1997	1998	1999	2000	'95-2000
Mkt. Benchmark[a]	$ 2.90	$ 2.65	$ 2.33	$ 2.24	$ 2.05	$ 2.09	$ 2.43
Average of Services[b]	$ 3.03	$ 2.63	$ 2.32	$ 2.17	$ 2.02	$ 2.13	$ 2.42
# Above Average[c]	18/25	9/26	11/25	7/23	14/26	15/27	7/17
Average Gain or Loss[d]	+13¢	−2¢	−1¢	−7¢	−3¢	+4¢	+7¢

[a] 24-month average price, 12-months before and 12-months after harvest.

[b] Average price received if advisory services' advice was followed.

[c] Number of advisory services that provided a net price above benchmark price and the number of advisory services that that gave advice.

[d] Benchmark price minus advisory services' average price.

Table 3. Pricing Performance Results, Beans, 1995-2000.

	1995	1996	1997	1998	1999	2000	'95-2000
Mkt. Benchmark[a]	$ 6.26	$ 7.08	$ 6.30	$ 5.86	$ 5.50	$ 5.42	$ 6.20
Average of Services[b]	$ 6.59	$ 7.27	$ 6.38	$ 5.82	$ 5.67	$ 5.45	$ 6.32
# Above Average[c]	21/25	13/24	13/23	7/22	16/25	12/26	7/17
Average Gain or Loss[d]	+33¢	+21¢	+8¢	−4¢	+17¢	+3¢	+12¢

[a] 24-month average price, 12-months before and 12-months after harvest.

[b] Average price received if advisory services' advice was followed.

[c] Number of advisory services that provided a net price above benchmark price and the number of advisory services that that gave advice.

[d] Benchmark price minus advisory services' average price.