


“LGM for Cattle Basis and Purchasing Considerations”

Understanding Risk Management Using Livestock Gross Margin Insurance

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Understanding Risk Management Using Livestock Gross Margin Insurance



Home Study Course
Chapter 4
LGM for Cattle Basis and Purchasing Considerations

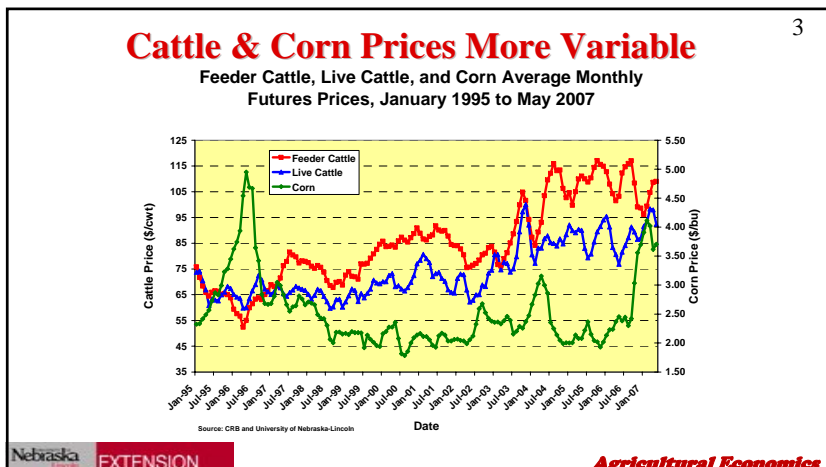
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Chapter 4 Objectives

- Basis risk associated hedges using LGM for Cattle insurance
- Optimal purchasing times for LGM insurance periods
- Historical indemnities

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Basis Risk

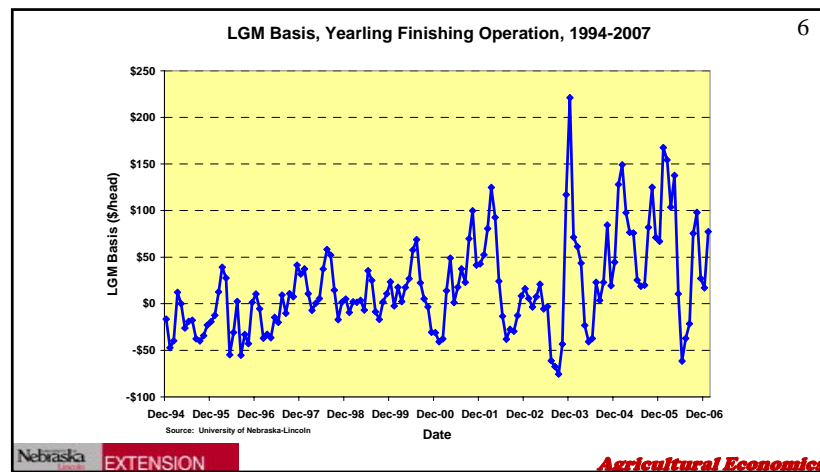
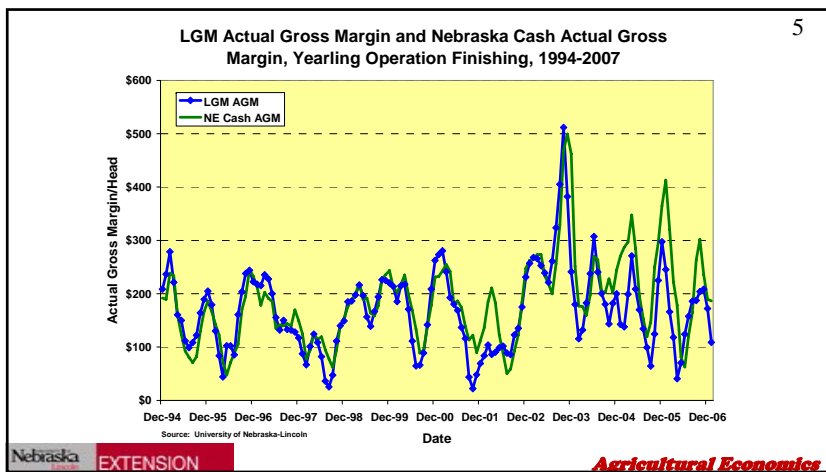
- Changes in the relationship between cash price and hedged price
- **Futures Basis = Cash Price – Futures Price**
- **LGM Basis = Cash Price – LGM Adj. Futures Price**
- **LGM Basis Margin is the spread between fed cattle, feeder cattle, & corn basis**

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Your LGM Basis

- **Difference between your purchase/selling price and LGM Adj. Futures Price**
 - ✓ Different locations
 - ✓ Different times
 - ✓ Different market conditions

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Insurance Periods

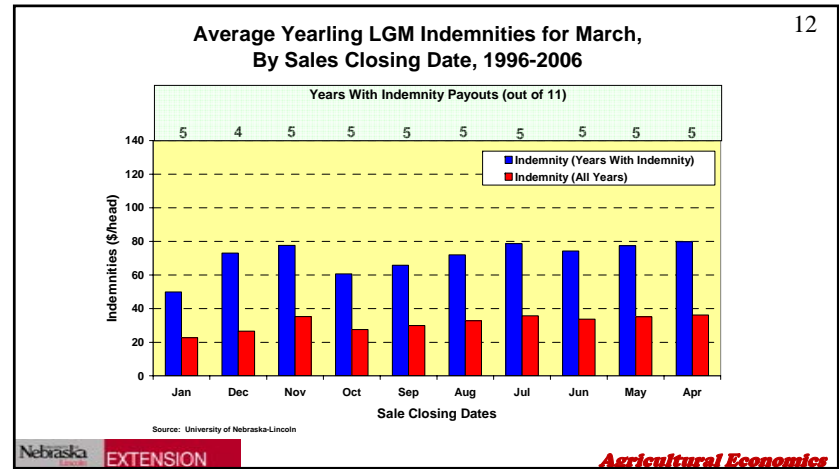
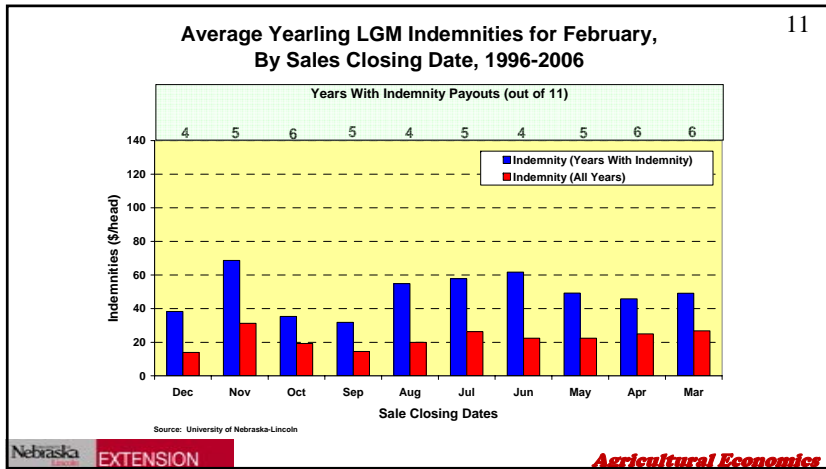
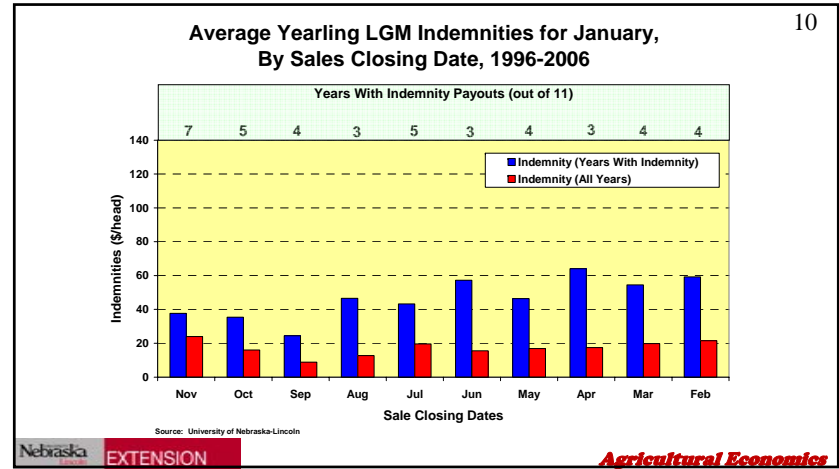
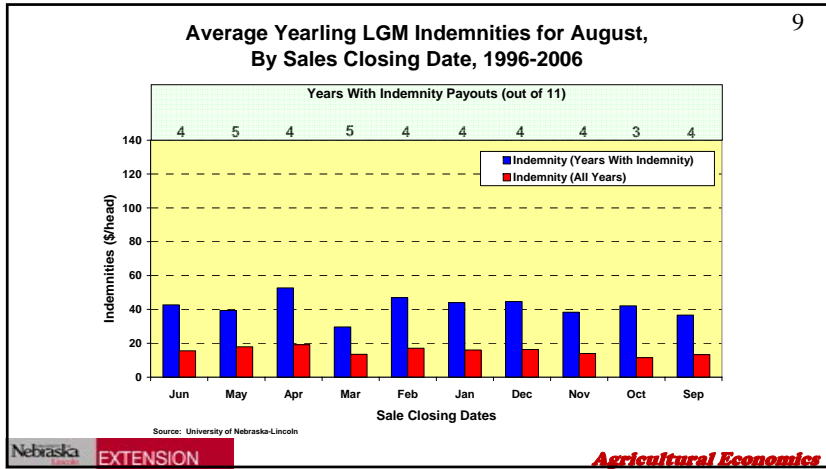
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec		
	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	
		Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb

- **EGM in August will be different depending on whether LGM is purchased in Jan, Feb, Mar, etc.**

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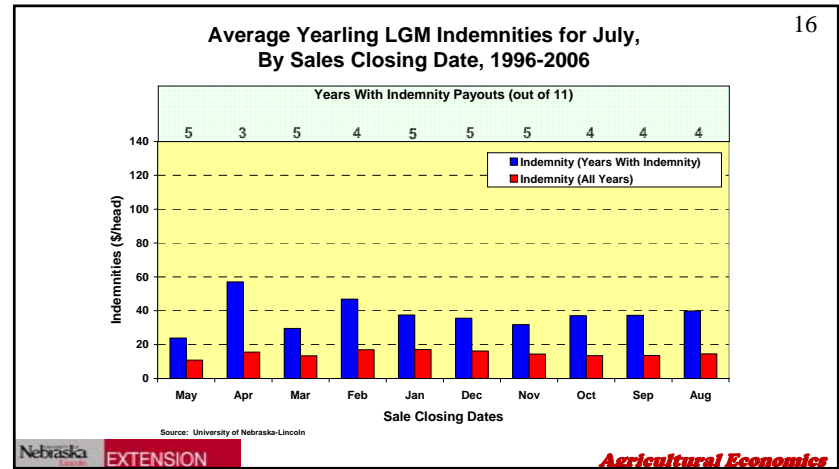
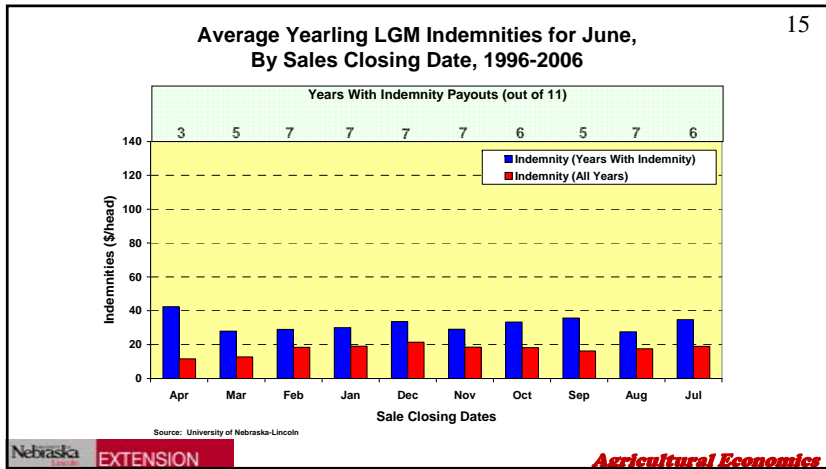
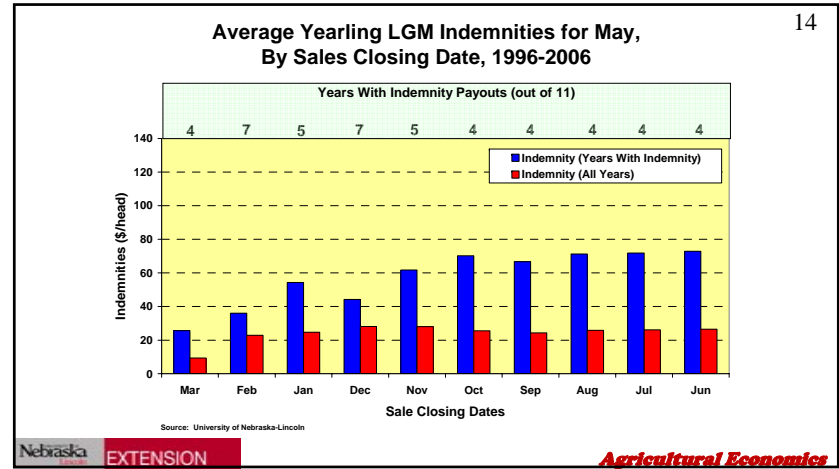
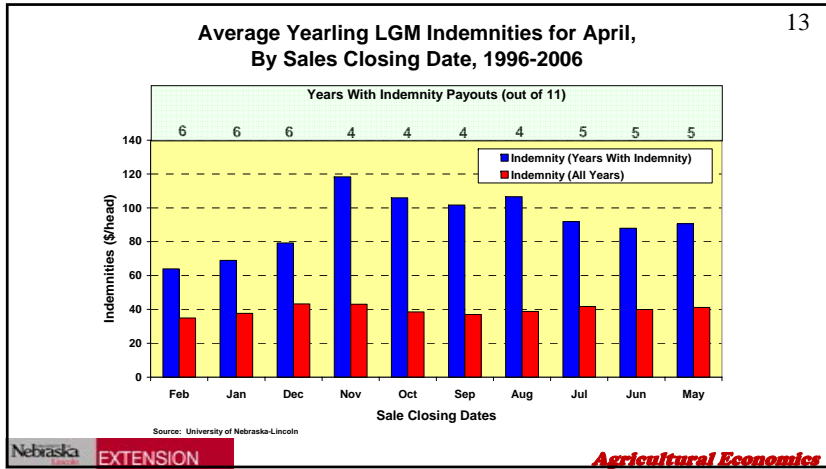
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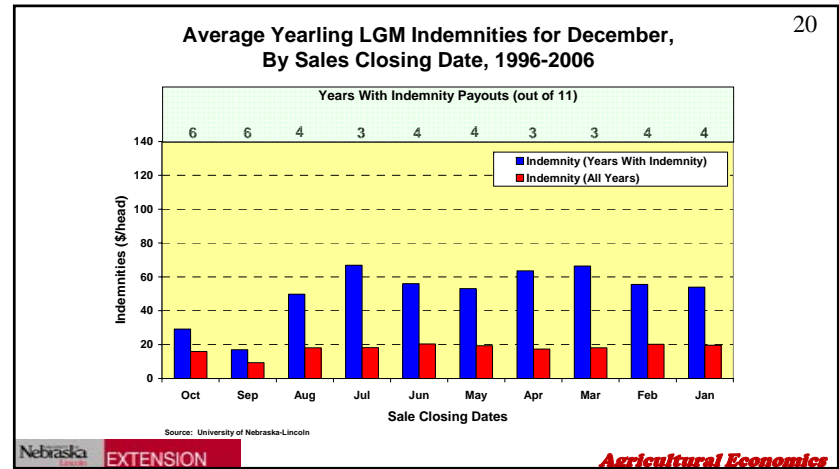
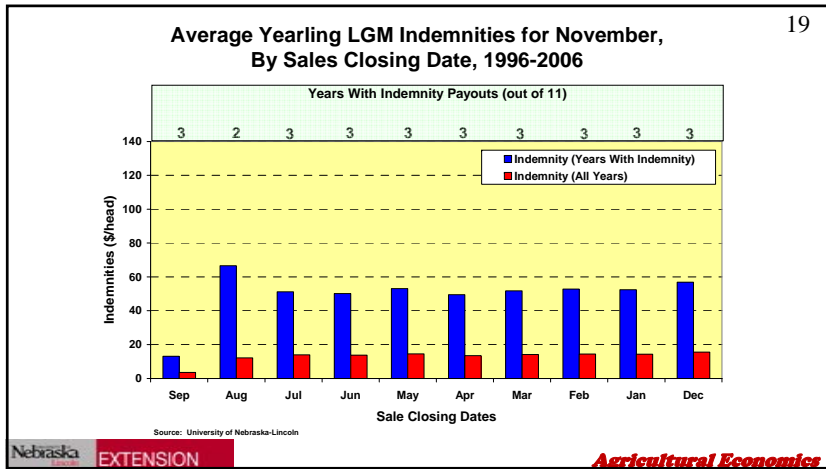
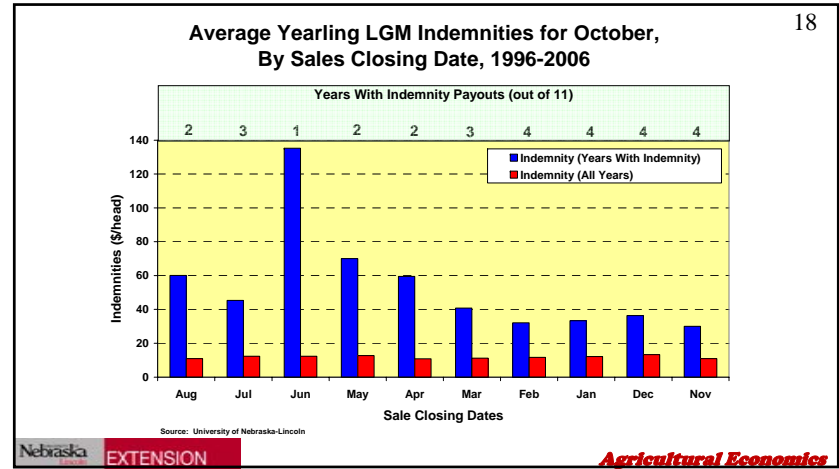
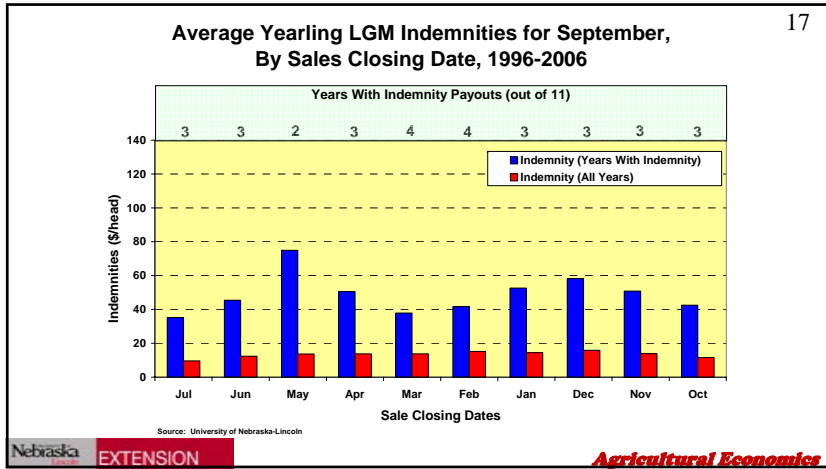
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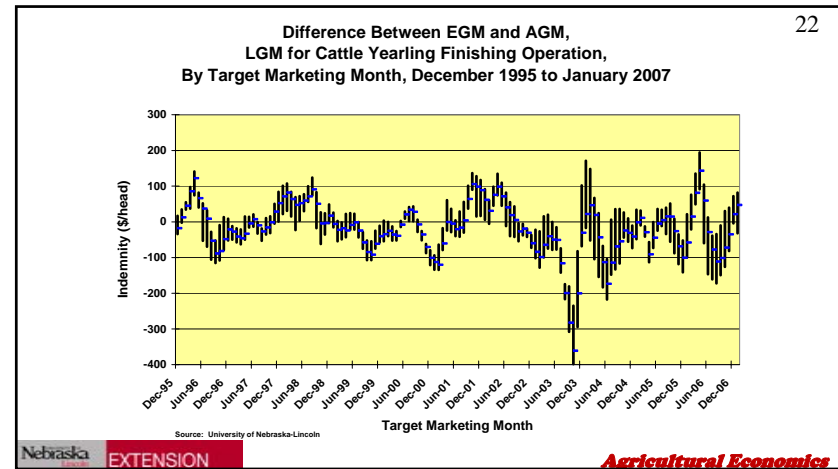
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Historical Indemnities

- **Use with caution!!**
 - ✓ Past performance not indicative of future results
- **Consider trends**
 - ✓ Indemnities were largest for winter target marketing months & smallest for summer
 - ✓ Some months were largest for earliest sales closing dates
 - ✓ Don't place a lot of weight on large average indemnity if it seldom occurs

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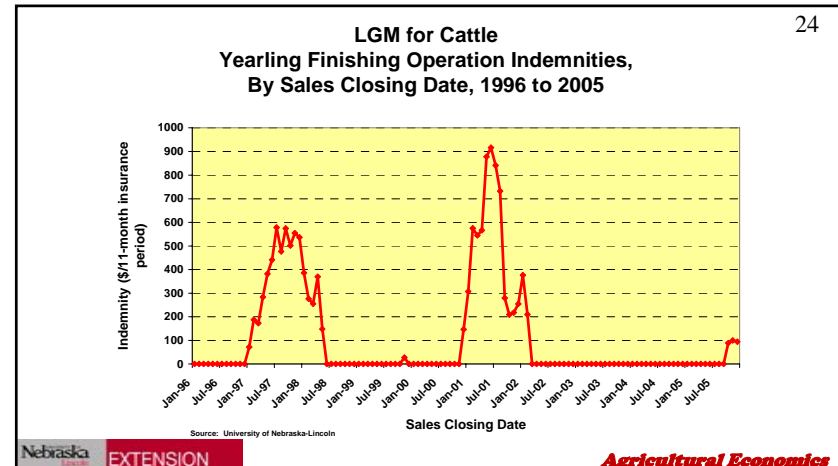
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LGM Insurance Period

- Indemnities are based on GMG and total AGM for the entire insurance period
- Previous examples assumed one head of target marketings in just one month

Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec

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Summary

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- LGM basis margin exists
- No clear trends in selecting sales closing dates for individual target marketing months
- LGM indemnities based on entire insurance period's GMG and total AGM

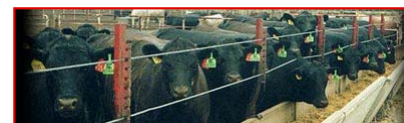
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What's Next?

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- Chapter 5: Hedging Outcomes with LGM Insurance
 - ✓ How price changes affect gross margins
 - ✓ How to set up and evaluate a hedge using LGM insurance



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