



Market Advisor

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CME changes feeder-cattle index

The Chicago Mercantile Exchange (CME) has modified the way it computes the CME feeder-cattle index. The change will affect the August 2005 feeder-cattle futures contracts and all subsequent contracts.

Calculating change

Two specific changes were made to the index calculations. First, USDA medium- and large-frame No. 1 to No. 2 steers have been added to the previous category of medium- and large-frame No. 1 steers. Second, the weight range for feeder steers has been expanded to 650 to 849 pounds (lb.) from 700 to 849 lb. The changes were made to increase the total number of price observations available to compute the index.

The addition of the No. 1 to No. 2 steer category likely will have a downward effect on the index because No. 2 steers usually sell lower than the No. 1 category. However, the addition of 650- to 699-lb. steers will tend to have an upward effect on the index, because those steers typically sell for more than their heavier counterparts.

The CME feeder-cattle index is important. Instead of actual delivery to settle an open contract, all open contracts after the termination of trading on the last Thursday of the contract month are settled using the index price for that day.

The index is a proxy for the cash market. The index and the closing futures price at contract maturity can be expected to be equal or within a few cents per hundredweight (cwt.) of each other.

The feeder-cattle index is based on all feeder-cattle auctions, direct trades, video sales and Internet sale transactions within the 12-state region of Colorado, Iowa, Kansas, Missouri, Montana, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, Texas and Wyoming, for which prices are reported by the Federal-State Market News Service. The seven-day index is calculated Monday through Friday, with each day's calculations available on the CME Web site at www.cme.com.

Comparing results

The change actually was implemented during the first week in June. The new

categories were added on June 1, and by June 7 the index included all observations from the new categories. The index on June 27 was \$112.06.

An important question for producers who may be contemplating using CME futures or options or the new Livestock Risk Protection insurance (LRP) is how the changes will affect the basis for feeder cattle to be sold in the future. The "basis" is the difference between a local cash market price and the index.

Quickly comparing the daily observations for the old index with what the new index would have been for 2001 through 2004, the new index averaged 24¢ per cwt. higher for that four-year period. The relatively small difference could be expected because of the downward and upward price effects that were added to the index.

Feeder cattle futures contracts are available for January, March, April, May, August, September, October and November, so those average monthly differences also were calculated. The new index averaged 68¢ per cwt. higher for January, 73¢ for March, 67¢ for April, and 15¢ for May. However, the new index averaged 11¢ per cwt. lower than the old index in August, 3¢

in September, 29¢ in October, and 6¢ in November. In December, the new index moved back greater than the old index by 15¢ per cwt.

Feeder-cattle hedgers may see the basis decline about 70¢ per cwt. in January, March and April, with negligible changes likely in other contract months.

Contemplating the future

The quality and geographic location of an individual producer's feeder cattle still will be more important in estimating the expected basis level than the small differences between the two indexes.

For example, the average basis for 700- to 849-lb., medium- and large-frame No. 1 feeder cattle sold at the six markets reported by the Federal-State Market News Service in North Dakota historically has been very close to par (cash = index) at contract maturity. However, the range in cash prices has averaged about \$8 per cwt., with higher-priced cattle selling at \$4 per cwt. above (plus \$4 basis) the index and lower-priced cattle bringing \$4 per cwt. below (minus \$4 basis).

The challenge for producers is to know how their feeder cattle sell compared with others when they are marketed. Granted, that can be difficult due to the many factors that affect the market prices of feeder cattle.

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