

Do You Need a Market Advisory Service?

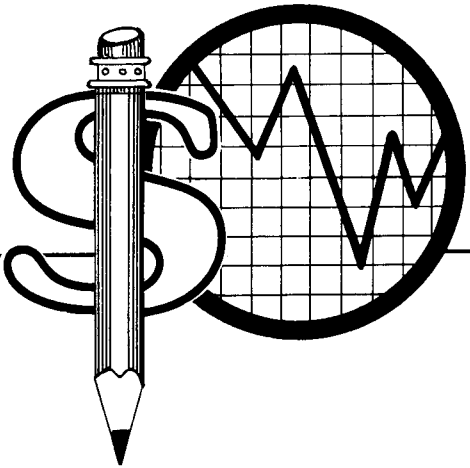
Producer Marketing Management— Fact Sheet #14

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Volatile grain and livestock prices along with the importance of marketing decisions to the financial health and profitability of farm businesses have caused some farmers to seek a market advisory service for professional help in marketing. Additional factors that also can affect this decision include heavy demands on the farmer's time in managing large and complex livestock and/or crop production enterprises and a feeling that hedging, options markets, generic commodity certificates, technical analysis, and basis behavior are too complex to understand.

Only you can answer the question, "Should I subscribe to a market advisory service?" Your answer depends on your farming operation, your skills and knowledge of marketing, and your ability to make marketing decisions under conditions of uncertain and volatile prices.

A good starting point in evaluating your need for an advisory service is to calculate the average prices you have received for your crops and livestock during the last three

or four years and compare these with the annual average prices in your state. State average prices can be obtained from the extension service of your land-grant university. If the prices you have received are consistently at or below the state average, that's an indication your marketing program needs improvement.

For some farmers, the "right" answer to this problem is to hire an advisory service. For others, the answer is to spend additional time improving their marketing skills, studying market conditions and trends, and adjusting their thinking to recognize that this is work and is as much a part of the job of running a farm business as planting or harvesting the crops.

What To Expect from an Advisory Service

If you decide to hire the services of an advisory firm, you likely will find that you need a solid understanding of marketing procedures such as hedging, various types of elevator and packer forward contracts, and use of options

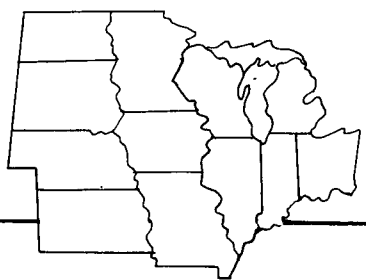
markets. You will need to be knowledgeable in these areas in order to obtain maximum benefits from the marketing advice of advisory services.

In addition, to gain the maximum benefit from recommendations of many advisory services, some understanding of commodity charting and technical analysis is helpful. Many market advisory services base sales recommendations (or feed purchase recommendations) on chart buy and sell signals. These signals often occur with little advance notice. Since timing is important for effective marketing, it is helpful to know what market signals your advisory service is monitoring and what those signals mean.

Information about technical analysis, hedging, options markets, and elevator contracts is available in other NCR #217 Marketing Management Fact Sheets that can be obtained from county and state extension services in the North Central Region.

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In short, if you hope an advisory service will eliminate your need to study and understand the complex business of grain and livestock marketing, you probably are in for a disappointment. If you are looking for help in timing marketing decisions, or for an outside party to help you pull the marketing trigger, a marketing advisory service may be helpful in your operation. But be realistic about what to expect from any advisory firm. Don't expect it to enable you to consistently sell your crops or livestock at the highest price of the year.

Most advisory services have as their objective a more realistic goal of recommending sales at above-average prices and at prices that will be profitable for your farm business. Some specifically aim for sales recommendations in the upper one-third of the annual price range for the commodity involved.

Types of Market Advisory Services Available

Many different market advisory services are available, ranging from small local firms to larger ones with clientele in most major agricultural areas of the country. Most advisory firms offer several types of services, with annual costs depending on the number and complexity of services to which you subscribe.

Almost all advisory services offer at least a weekly newsletter that reviews current fundamental (supply/demand) and/or technical (charts, figures, moving averages) market developments and contains specific marketing and purchasing advice.

Sometimes marketing recommendations of these services are separated into those for (1) farmers who use only cash and forward contract markets, (2) "conservative" hedgers who use futures markets but do not repeatedly trade in and out of a hedged position, and (3) "selective hedgers," who may place and lift hedges for the same crop several times, or who may replace speculation in the physical commodity with speculation through ownership of long futures or options positions.

Other advisory services do not make these distinctions, but provide general recommendations that can be used both by sellers in cash and forward contract markets and by hedgers.

Some newsletters place heavy emphasis on technical analysis, including chart patterns, moving averages, relative strength indices, Elliot Wave patterns, and cycles. Others include a blend of fundamental and technical analysis. Some concentrate primarily on supply-demand developments such as export movement and sales, soybean crushing activity, CCC loan and sales activity, U.S. and foreign crop prospects, government program developments, livestock slaughter, meat demand, and similar fundamental factors. Other newsletters place emphasis on both U.S. and world economic conditions, while some give more emphasis to U.S. developments. Still others primarily emphasize livestock market analysis and marketing recommendations, with only limited detail on grain markets. In 1989, costs for most market newsletters varied from \$50 to \$500 per year.

Along with newsletters, many advisory services have hotlines that you can call during the week for updated market information and marketing recommendations. With some firms, you are required to pay for the phone call plus an additional charge for this extra service; with others, you have access to a toll-free line but are charged extra for the service. In some firms, the hotline contains a recorded message. In other cases, it connects you to advisory service personnel who are available for consultation about your specific marketing problems. Some services also have a computerized information delivery service through which you can receive market information and recommendations over a video screen or in hard-copy form if you have a microcomputer, modem, and printer.

Many advisory services supplement their newsletters, hotlines, and computerized information delivery systems with seminars several times during the year. Some seminars provide more detail about the market situation and outlook, the firm's marketing recommendations, and reasons behind the recommendations. Other seminars focus on how to use marketing tools such as futures and options markets. Fees for such services often range from \$50 to \$250 per person per seminar, in addition to annual charges for other services obtained from the advisory firm.

At least a few advisory services also have available to clients a "managed-marketing" program. With this service, the advisory firm takes over the entire marketing job for the farmer, for an annual fee. Fees for such ser-

vices may vary from a few thousand dollars per year to a percentage of gross receipts, or a specific charge per acre or per head of livestock marketed.

If you use such services, it is important to have a written contract and to carefully read the contract details so that you fully understand your obligations and the obligations, responsibilities, and limits of liabilities of the market advisory service.

Some market advisory firms also are affiliated with commodity brokerage firms. In that case, they can refer you directly to brokers from their organization if you are managing your own marketing program and decide to use futures or options markets.

Performance of Advisory Services

If you are considering hiring an advisory service, it would be desirable to have an independent analysis of past performance of various advisory services so you can compare their records. Unfortunately, to our knowledge, no such comparison is available that would include the majority of U.S. market advisory firms. However, a Western Illinois University analysis of the corn marketing recommendations from three major market advisory service firms for 1980 through 1984 gives an idea of how some services have performed.¹ This five-year period included two short U.S. crops (1980 and 1983), which led to high and volatile corn prices in those marketing years.

The researchers compared marketing results from advisory service recommendations with those from cash harvest-time sales.² Average returns from one advisory service's recommendations over the five-year period were \$.03 to \$.07 less per bushel than would have been obtained through cash harvest-time sales. The \$.03 lower average return was from hedging recommendations, while the \$.07 lower average return was from strictly cash sales. For this same firm, some individual years showed returns \$.27 to \$.62 per bushel less than harvest prices, while returns in other years were \$.11 to \$.33 per bushel greater than the harvest-time cash market.

A second firm in the study showed five-year average returns for the strictly cash marketer \$.08 less per bushel than those from harvest-time prices. For that firm, recommendations for what is referred to as "conservative" hedgers gave the same price as harvest sales, while its "selective hedger" recommendations generated an average of \$.08 more than harvest-time sales. "Conservative" hedgers were those hedging through one-time trades, while "selective" hedgers were those willing to place and lift futures positions for the same grain several times during the year. The difference between this firm's returns and harvest-time prices also varied widely from year to year, with extremes ranging from \$.57 above to \$.49 below the harvest-time cash market. The third firm provided only one set of recommendations, and those netted \$.32 more per bushel than harvest prices over the five-year period.

A common problem with these firms was a tendency to make sales recommendations either too early or too late in drought-induced short crop years. In the three years of normal crops, all three advisory services' recommendations generated larger returns than harvest-time cash prices, with typical returns those years ranging from \$.10 to \$.40 per bushel above harvest prices.

The top-performing advisory service priced 1980-crop corn too soon in the 1980 drought year, but took advantage of strength in the distant futures to price the next two years' crops at very attractive prices. In 1983, it repeated a similar forward-pricing strategy in distant futures contracts for 1984-crop corn and also was able to sell the 1983-crop corn at an average price \$.01 per bushel above the harvest-time price.

To gain these price benefits, it would have been necessary for subscribers of the service to understand and use complex hedging strategies, and to have a lender who understood and supported the strategies with financing for possible margin calls. Thus, farmers not highly knowledgeable about marketing tools almost certainly would have received considerably less than the maximum potential benefit from the top-performing advisory service.

It also should be recognized that the past record of an advisory service is not necessarily an accurate indicator of future performance. One reason is that commodity options are now available and may improve marketing performance in short crop years or in an upward-trending grain or livestock market.

Commodity options can be used to remove much of the downside price risk of grain or livestock sales, while letting you take advantage of higher prices if the market should strengthen dramatically after you have priced your product. As with all marketing tools, higher prices do not automatically result from the use of options markets. And, as with hedging, forward contracting and cash sales decisions, timing is critical for profitable use of commodity options markets.

Cautions in Using Advisory Service Recommendations

Typical advisory services offer market advice in the form of recommendations that tell the client to sell a specific percentage of marketable supplies at the time the newsletter is written or the telephone hotline is updated. These recommendations are intended to fit an "average" or "typical" producer. However, the level of sales appropriate for your situation in some cases may be different than that for an "average" farmer, depending on your costs of production, financial risk-bearing ability, and level of production risk.

Let's say, for example, that you are a hog producer with high debt, limited equity in your business, and have above-average total production cost per hundredweight. Also, let's say the futures markets are offering an opportunity to lock in your full cost of production and a modest profit for several months out and that your advisory service is recommending only a 50 percent sales level in anticipation that prices will strengthen modestly.

If you are in that situation, it should be recognized that the average producer can take a larger decline in the market than you can and still keep his/her operation profitable. In this situation, a sales level considerably higher than 50 percent might be appropriate for you.

On the other hand, if you are a producer with below-average costs of production and large equity in your business, you might be able to justify a lower sales percentage than the advisory service is recommending.

If you operate an irrigated crop farm, your production risk probably is lower than for nonirrigated operations of the "average" farmer. Thus, irrigation in some cases also may be a factor making it appropriate to boost new crop sales levels in tailoring preharvest market advisory service recommendations to your farming operation.

Or, if you are a nonirrigated crop farmer in an area or soil type with higher production risk, that might shift your preharvest marketing decisions in favor of using the options market or minimum-price contracts for forward pricing even though your advisory service is recommending the use of hedges or fixed-price forward contracts. As an alternative to making these adjustments yourself, some advisory services make specific marketing recommendations for your farm.

Other Benefits of Advisory Services

In addition to specific marketing recommendations, advisory services can be valuable in keeping abreast of world crop conditions, technical market analysis, market psychology,

and government policy developments that affect agriculture. If there is a good farm radio station in your area, you may be able to get much of this information from that source as well as from outlook materials and educational programs that are available through extension services of land grant universities. In some areas, however, this information may be difficult to obtain except through advisory services. Also, an advisory service can stimulate your marketing creativity by exposing you to marketing approaches being used by farmers in other parts of the country.

Nonadvisory Information Services

In addition to market advisory services, a number of firms and some land-grant universities provide market information without specific marketing recommendations. Some of these organizations deliver information by means of video screens, side-band radios, or through telecaption adaptors for television sets. Others provide the information through a video screen with an attached printer, while some transmit it only through a printer or through telephone access with a microcomputer. Some information services provide instantaneous futures price quotations. Other systems provide futures prices that lag several minutes from current quotations. These services usually provide much other market-related information along with prices, including export shipments and sales, processing activity, the amount of participation in government programs, livestock slaughter and meat demand information,

U.S. and world weather, and various technical indicators. Costs for these services vary widely from one source to another and may be more or less than the cost of market advisory services. For farmers who are skilled in marketing and know how to evaluate and use all available marketing alternatives, these nonadvisory information services can be a valuable help in timing marketings and developing a marketing strategy.

Considerations in Selecting an Advisory Service

Suppose you have decided you need a market advisory service. The next step is to select the firm that best fits your needs. If you are not familiar with the various advisory service firms that are available, a starting point for a list of possible firms might be to check with neighboring farmers who subscribe to such services. You also may be able to get names of advisory service firms and background information about them from local lenders, elevator managers, and your county extension office.

When you inquire about potential suppliers of marketing advice, ask about the stability of the firm, how long it has been in business, the size of its research department, and whether its primary emphasis is grain or livestock marketing, or both. You also may want to know where the firm's main geographical base of clientele is located. Some advisory services have a nationwide base of clientele, while others may do business mostly in the eastern or western cornbelt, the South, or in wheat-milo-

livestock areas of the plains and western states. Market conditions and appropriate marketing strategies for the same crop or livestock may differ somewhat, depending on the area of the country where you are located. For that reason, you would probably want an advisory service that has a large clientele base in your area and understands your local market conditions as well as developments affecting futures markets.

After you have narrowed the list of potential firms to a small number, it would be advisable to call each firm's headquarters to discuss the services offered, to get its philosophy about risk-management in farming, and to see whether you can communicate well with its personnel.

Ask for a written record of the firm's marketing recommendations for recent years. Most reputable firms should have this information available and should not be reluctant to send it to you.

You may find it helpful to ask the advisory service for recent sample copies of its market letter so that you will have a good idea of whether its written advice is clear and easy to understand, as well as the kind of information and types of recommendations you would be getting if you subscribe to its services.

It also is a good idea to acquire the names and addresses of farmers in your area who receive these services, so that you can get first-hand recommendations concerning the firm's strengths and weaknesses, and the benefits, if any, that other producers have received from their services.

Finally, inquire about costs for the types of services you desire and costs of additional services such as telephone hotlines, commodity price charts, and attendance at marketing seminars conducted by the firm. Costs for these services will vary from one firm to another. However, selection of an advisory service should be based not just on cost of service, but also on the types and quality of information and advice available through the advisory firm.

Finally, it should be emphasized that not every producer needs a market advisory service. Some farmers and ranchers are able to upgrade marketing skills through personal study, and through educational materials and workshops conducted by extension services of land-grant universities and commodity exchanges. Others, because of their background, interests, and types of business may find an advisory service valuable in marketing their grain, oilseeds, and livestock.

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¹Results of this study by Keith Rogers and Marsha Thurow were reported in "Is Market Advice Worth What You Pay for It?," *Wallaces Farmer Magazine*, Des Moines, Iowa, June 28, 1986.

²Performance of these advisory firms likely would have appeared less favorable if the season average price had been used as a base for comparisons, since harvest-time prices have a strong tendency to be the lowest prices of the marketing year.



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