



**Ryan Walsh**  
**COMMODITY**  
**BROKER**  
**815-284-9792**

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## THE MYTH OF DIVERSITY

All is well in the world again. Commodities have been running over the past few months, equities continue to climb making two year highs and the Fed is pursuing a loose monetary policy. Investors have begun to settle back into the status quo of long only equities investments only this time they are mindful of how quickly that can turn against them. To battle this, a number of clients have told me they are going to diversify this time around. A great plan but unfortunately by diversify they mean holding many different stocks from multiple sectors. The real risk here is equity index correlation.

The overwhelming majority of stocks are positively correlated with equity index returns. Mutual funds even more so since they seek to emulate the indices themselves. As an example, here is a breakdown of correlations of each economic sector to Dow returns for October 2008 and this past week:

Financials: 97% (Currently: 85%)  
 Energies: 89% (Currently: 94%)  
 Utilities: 92% (Currently: 9%)  
 Health Care: 93% (Currently: 94%)  
 Consumer Staples: 90% (Currently: 97%)  
 Industrials: 98% (Currently: 98%)  
 Raw Materials: 96% (Currently: 95%)  
 Technology: 97% (Currently: 98%)  
 Consumer Discretionary: 95% (Currently: 97%)  
 Source: Select SPDR ETFs

As you can see all economic sectors fell with the Dow in October of 2008 and all but one are rising lock step with the Dow on the current bullish equities run. By passively investing in multiple sectors you are not achieving true portfolio diversification. This leads to a powerful conclusion: invest in and diversify across several asset classes to avoid equity index correlation risk. Managed futures offer a non-correlated asset class that adds true diversification to your current portfolio construction by offering not only diversity of instruments but diversity of strategy as well. The ability to actively go long/short combined with professional risk management delivers a powerful ally in the creation and maintenance of investment returns. Please give us a call to discuss the direction of your portfolio.

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**AGPERSPECTIVE INC**

R I S K M A N A G E M E N T

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2011 A Golden Opportunity

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AgPerspective Inc is an equal opportunity insurance provider.



**Brian Freise**

**PRESIDENT/  
 CROP  
 INSURANCE  
 SPECIALIST**



## 2011 A GOLDEN OPPORTUNITY

As is obvious to all, 2011 has the makings of being a very profitable year in production agriculture. Every year, our company computes the cash flow for a hypothetical farm that we feel is fairly representative of our client base (if you would like to see a copy of this please contact our office). This year our corn and soybean breakeven is around \$4.00 and \$9.30 respectively. A common goal for producers is to achieve a \$50 per acre profit. With current prices it is possible for one to achieve 3 or 4 times that goal in 2011. It is *A Golden Opportunity* to say the least.

With that said, we also realize that few producers have done anything to lock in this profit margin. This is understandable considering every time in the last six months a producer has made a sale the market makes it look like a mistake the next day. The producer is comforted by the fact they know it was still a profitable sale, as they should be; however, the psychology of this can get the better of even the savviest of marketers. So what is a producer to do? Well, the easiest thing is to do nothing. The market place is clearly bullish for what we feel to be very good reasons. Doing nothing is certainly a very tempting alternative and one that many will choose. However, from a risk management standpoint it is not a very good one.

History has repeatedly shown us that even when things look very bright something completely unexpected can happen. In recent years we witnessed the Lehman Brothers fiasco put an end to an impressive commodity run. This was a turn of events that virtually no one, absent a few Lehman executives, saw coming. Even though our firm has a bullish slant to the market we feel doing nothing is simply not an option. We recognize that the market has a tremendous way of humbling those with too strong of opinions. I recently heard an economist quoted as saying to a group of farmers, "When was the last time you were worried about \$3.00 corn." The answer of course is June 2010 or about six months ago.

*Continued on special insert....*



1319 N Galena Ave  
 Dixon, IL 61021  
 815-284-9792  
 www.agperspective.com



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## COUNTY ADVANTAGE LITE AND ADMAX

Crop insurance is often perceived as a stagnant and unchanging industry, which is an enormous misconception. This bias often leads producers to commit to buying the same insurance product year in and year out without much research. Each year presents a new set of circumstances which need to be considered when selecting a crop insurance policy. Crop insurance underwriting companies also introduce proprietary products each year to enhance the federally subsidized insurance you are already buying. In large part, these proprietary products have no fit alongside your current crop insurance policy or are simply too expensive for producers to consider. AgPerspective believes there are two proprietary products this year that need to be taken into consideration when purchasing your federal crop insurance. County Advantage Lite and ADMax, offered by ADM Crop Risk Services, are the two products we believe are price competitive and have great value in the correct situation.

County Advantage Lite is a brand new product released for the 2011 crop insurance year. County Advantage Lite is a supplemental policy to a GRIP or GRIP-HRO policy. It provides coverage on the producer's crop exposure in the event of an individual yield loss very similar to an APH policy. This policy can also be purchased up to a 90% guarantee in contrast to a Revenue Protection policy which can only be bought up to a 85% guarantee. There is no price protection built in to the County Advantage Lite policy. A payment will trigger only in the event of an individual yield loss. A GRIP policy and County Advantage Lite policy fit together in such perfect harmony because GRIP offers excellent price protection and County Advantage Lite protects your individual yield. The cost for this supplemental coverage can range from \$2-\$5 per acre. In a claim situation, the policy that would pay the greater indemnity would be the amount you are entitled too. Here is an example of exactly County Advantage Lite works:

Grower carries GRIP 90% coverage with 80% price election and chooses to carry County Advantage Lite at the 90% level.

Grower turns in a claim

Claim is worked by an adjuster

Claim is computed using APH rules except grower has 90% coverage level

Adjuster determines loss of \$100/acre

Grower is paid immediately

In April when GRIP payments are released, it is determined that grower's GRIP policy will pay an indemnity of \$150/acre

Grower will be paid an additional \$50/acre for a total of \$150

What if GRIP indemnity would be \$0

Grower would keep the \$100/acre

Grower always receives the highest payment i.e. GRIP indemnity or County Advantage Lite indemnity

The second product offered by ADM and AgPerspective, ADMax, is a private product that can be added to a Revenue or APH policy. ADMax is a "yield" coverage product similar to an APH policy. The ADMax product is offered in 5%-10% increments, which allows you to cover your individual APH up to 90%. This policy can be written with basic, optional or enterprise units. ADMax is a good fit when a producer is looking for a 5% boost on yield coverage because it seems that in a year when their crop is short that they seem to be just short of a claim payment when buying only an 85% coverage policy. ADMax is estimated to cost about \$5 per acre. An example of how ADMax works is the best way to explain this policy.

APH: 180

Underlying Policy: 85% RP(Revenue Policy)

Underlying Policy Base Price: \$5

ADMax Bushels Guaranteed

$(180 \text{ aph} \times 90\%) - (180 \times 85\%) = 162 - 153 = 9$  Bushels Guaranteed by ADMax Policy

If you want to learn more about County Advantage Lite or ADMax please contact our office. We will be happy to meet with you and provide you with more information on how these two products work!



**TROY  
RASMUSSEN**

**AGPERSPECTIVE  
COMMODITIES**

**TROY  
RASMUSSEN  
OR  
RYAN WALSH**

**815-28GRAIN  
(815-284-7246)**

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## CAPITALIZING ON A "GOLDEN OPPORTUNITY"

Producers face potential windfall profits for 2011 as commodity prices have rallied in the latter half of 2010 on tight supplies only after most locked in input costs for the upcoming year. The timing of the 2010 rally has many frustrated with old crop sales but due to the late season event, suppliers had already set prices and were unable to push inputs higher as was the case in 2008. Certainly the frustration of selling corn in the low \$4 per bushel range in 2010 limited profit potential for the year, but it's now time to focus on profits that could potentially exceed \$200 per acre for 2011. Locking in these profit levels while remaining positioned for a possible extension of the rally is the challenge we are faced with.

Most are asking the question "How high can this market go"? No one knows that answer but we know it won't last forever. One must focus on protecting profit while being able to be a part of a further rally with defined risk parameters. Don't attempt to guess where it might go or it will drive you crazy. The market has a tendency to become more violent as price rises, and sure as the sun will rise in the east, producers will get cut up in days to come due to poor planning.

When producers look to add price floors under 2011 production they have three choices. First is to lean on what could be excellent crop insurance floors that are yet to be established prior February 28th; as mentioned in our earlier article. Certainly this is a great play as long as price holds steady or rises until that date, if it doesn't profitable hedge floors will be lower. Secondly, sell grain and buy CALL options which will roughly capture half of the futures move based on your strike price selection. Thirdly, with a bull trend in place, buy PUTS at key price points and if the rally continues the unsold grain will gain at the same pace as futures less basis changes. We prefer buying PUTS to protect against falling price from today until crop insurance floors are established late in February. This allows for the greatest upside potential in the unsold grain.

The simple way of assessing the need for these maneuvers is by quantifying the risk. An average 1500 acre producer with a 50/50 corn-beans rotation has a gross investment in the crop of \$546,000 for corn and \$362,000 for beans totaling \$908,000. This number really isn't a true assessment of current risk, it's simply the invested risk in the inputs of the crop. True price risk is based on the current asset value of the crop determined by current price. For ease of calculation let's assume price is \$5.50 for new crop corn and it is incapable of dropping below \$3.50 for 2011; again an assumption for illustration only. Let's also assume current new crop beans are \$13.00 and that price won't drop below \$8.50 for 2011. In this example the producer has \$277,500 of price risk for corn and \$175,500 of price risk for beans, a grand total of \$453,000.

The estimates above can be a real eye opener. By simply assuming price will continue higher producers are "swinging for the fence" in their marketing programs. There are simple methods to reduce that risk with a relatively small financial investment by combining crop insurance, sales, and option positions in a seamless program. We are unwilling to accept these high risk levels and prefer placing a short term floor under price until crop insurance floors are established.

Don't let this bull market catch you assuming there isn't much downside risk. December of 2008 was a shock to many people in the agriculture and financial sectors alike. Let's capture this "Golden Opportunity" in 2011 by hedging diligently.