

BASIS CONTRACT

Fix the basis and capture the market rally.

What is it?

A basis contract lets you lock in a basis level but leave the future prices open until a later time.

How does it work?

You sign a contract for a specified number of tonnes and choose a delivery period. You fix the basis and leave the futures open. You have the option of setting a target that will be triggered if the futures rise to that level.

What are the advantages of a Basis contract?

- You can lock in an attractive basis and wait for a potential market rally.
- You can deliver your grain and leave the futures portion un-priced.
- Delivery space is planned for your crop.

What should you know?

- You hold the downside futures risk.

When is it used?

Choose a basis contract if you think the basis is attractive, but you expect the futures to improve. This tool is often used in an inverse market (futures in later months are lower than the nearby).

Basis contract case study

It's April 15th and the July futures price is \$410/mt with a basis of -\$30/mt for a net cash price of \$380/mt. The market is inverse with a November futures price of \$380/mt. You decide to capture the attractive basis by signing a basis contract.

It's now June 15th and the futures market is rallying but is still in an inverse position. The July futures are at \$420/mt and the November futures are \$385/mt. Grain companies widen the July basis to -\$35/mt because they don't want added ownership ahead of a widening inverse. You lock in the July futures price of \$420/mt for a net cash price of \$390/mt.

In this scenario you gained three ways:

- Your net price is \$10/mt higher than the April 15th price.
- You avoided the \$5/mt widening of the basis on June 15th.
- You priced ahead of the inverse.