President's Half-Acre (Published in *Wheat Grower Magazine*) February 20, 2001
By Tom McCoy

Glance through any farm publication and you will find an article on marketing. Most of these articles say that to be a successful farmer you must have a **marketing plan**. Since I've made my share of mistakes in selling my crops, I read these articles closely, hoping to learn how to sell my wheat near the top of the yearly price range.

Unfortunately, although these articles often give some good advice, they never quite tell how to construct a marketing plan. They usually end by requiring me to specify a "realistic price objective" or a "yearly price range" – the very things I want the marketing plan to tell me. I finally concluded that the instructions in these articles are similar to the instructions that my brother-in-law received on how to drop an atomic bomb. He was a marine pilot and was particularly interested in learning how to get away from the blast after he dropped the bomb. He said that the instructor spent two hours going through how to approach the target and how to release the bomb. Then, when the instructor got to the part of the presentation that the pilots were most eagerly awaiting, he muttered a few inaudible remarks to the blackboard and said, "Class dismissed."

There are at least two reasons why articles on marketing plans don't provide clear instructions on how to identify when prices are "high." First, anyone who really knows how to predict prices could make a huge amount of money in the futures market and would be living very quietly in a big mansion in Lake Oswego. He would not be writing marketing articles.

Second, if there are enough informed buyers and sellers in the market, today's price should be close to the best prediction of tomorrow's price. Suppose information becomes available indicating prices will be 10¢ higher tomorrow. Buyers will compete among themselves and buy wheat today until the price is almost 10¢ higher **today**. If prices are expected to fall by 10¢ tomorrow, buyers will stop buying today and wait until tomorrow. Prices will fall by 10¢ today. Many studies have shown that today's price is the best guess of tomorrow's price and that price movements in the near future are not predictable.

I believe there are two special circumstances when prices may be predictable. First, if exporters have made big sales and have not purchased the wheat yet, bad news about future export demand may not be reflected in the current wheat price. If they have ships to load today, exporters can't delay purchasing wheat until prices are lower. Until their sales are covered, exporters will sometimes pay farmers more than they expect to pay in the future. This happened in the summers of 1997 and 1998. Hence, a fall in the wheat price next month may sometimes be predictable. However, competition among exporters should always cause good news to be reflected quickly in the current price.

Second, if market conditions -- wheat prices, the basis, or the carry -- are unusually high or low, there is a good chance that they will eventually return to a more normal level. Ten years ago, OSU Professor Larry Lev and Rob King of the University of Minnesota developed some useful rules for identifying when prices are abnormal and for making decisions about when to sell the crop. They showed that using their rules produced an average return somewhat better than always selling at harvest or selling in April. I hope to have a copy of the Lev-King paper posted on the OWGL web site soon.

Some articles propose using a farmer's cost of production as the basis of his marketing plan. Wheat should be sold whenever the market price exceeds the cost of production (including a fair profit). The problem with this approach is that the wheat price never exceeds the cost of production in some years. What do you do then? To make up for those years, I must sell at substantially more than my cost of production when prices are high. If I don't, I will eventually go broke. While it is very important to know your cost of production (e.g., to know if you should accept an offer to lease more land), I don't see a simple way that your cost of production can help you decide when to sell your wheat.

There are good reasons to believe that developing a plan to sell at the top of the market is not possible. Farmers should not feel guilty if they can't develop simple rules that tell them when to market their wheat. The rules developed by Lev-King come closest to a marketing plan that can be implemented using available information without requiring farmers to use their own price forecasts.

In the end, the main usefulness of a marketing plan may not be to tell you when to market your wheat, but rather to make you more aware of the costs of postponing sales (storage and foregone interest). Having a marketing plan will make you more likely to weigh these costs against the possibility that prices will rise enough to offset them. It is hard to develop a marketing plan that tells you when to sell, but it is easy to lose money by postponing sales without a good reason.