Dairy Risk Management
Tools for Producers
OVERVIEW OF MY DISCUSSION

- Program will highlight multiple tools, all of which have merit
  - Further explore what fits best for you
- I will briefly outline
  - Livestock Gross Margin (LGM) Dairy
  - Futures and Options
HOW CAN I COMPARE DMC AND LGM-DAIRY?
Dairy Margin Insurance Program

“Lock in” milk price over feed cost
- Milk price – class III milk futures
- Feed price – corn and soybean meal futures

Effective risk management tool

Offerings evolve with market
DMC VS. LGM-DAIRY

- Milk price difference
- Feed cost component
  - LGM can be customized
- Nature of the programs
MILK PRICE DIFFERENCES

- Margins offered can’t be compared directly
  - Not apples to apples
- DMC: US All Milk
  - Includes all milk classes
- LGM-Dairy: Class III Milk Futures
- Historically, US All Milk Price has exceeded class III by about $1.50 per cwt.
US ALL MILK MINUS CLASS III
US ALL MILK MINUS CLASS III
LGM-Dairy – Corn and SBM
- Producers can match feed quantities to milk production
- Min’s and max’s exist

DMC – Corn, SBM, and Alfalfa Hay
- “ration” is fixed for life of farm bill
FEED COST DIFFERENCES

- **LGM-Dairy** – corn and SBM futures
  - Default – 28 lbs of corn, 4 lbs of SBM, can be changed
- **DMC** – National corn, SBM, and Alfalfa prices
  - 60.1 lbs of corn (32.1 lbs more)
  - 14.7 lbs of SBM (10.7 lbs more)
  - 27.4 lbs of Alfalfa hay (27.4 lbs more)
- Adjust for price differences, match feed quantities, subtract Alfalfa component
FOR QUICK COMPARISON

- Set corn and soybean meal quantities in LGM to match DMC
  - Price differences will exist in feeds as well
  - Change is what matters
- Add US All milk minus class III milk
- Subtract impact of Alfalfa Hay
  - It is not included in LGM at all
- General rules of thumb
  - Default feed quantity: LGM margin needs to be $4.50-$5.00 higher
  - Match corn and SBM quantity: LGM needs to be $1.50 to $2.00 higher
NATURE OF THE PROGRAMS

- LGM-Dairy – futures based
  - Available insurable margins evolved with market
  - Good times = good opportunities

- DMC – a bit of a throwback
  - Countercyclical – margins and premiums fixed through 2023

- LGM-Dairy – more attractive in profitable times

- DMC – likely to pay in challenging times
WHAT ABOUT FUTURES / OPTIONS?
Class III and class IV milk

Settled based on USDA price for that class

200,000 lbs of milk
  - Limits ability for many to use

Available 24 months out – but thinly traded

Class III or IV differs from your milk check - basis
HEDGING THROUGH FUTURES

- Sell a class III futures contract for the month you wish to cover milk
  - *i.e.:* February 2021

- Class III milk futures decrease – gain on futures, offset decrease in your milk price

- Class III milk futures increase – lose on futures, gain on your milk price
Buy put option – right to sell – milk futures at predetermined “strike” price
  - I.e.: February class III at $16.50, buy $15.50 strike
  - If milk futures fall below $15.50, you gain on put
  - Self-insure first $1 drop
  - Price “floor” in place
  - Can still capitalize on rising milk prices
FINAL THOUGHTS ON LGM AND FUTURES

- Understand the tools that are out there
  - Including DMC and Dairy-RP
- LGM and futures allow you to capitalize on existing market conditions
  - LGM has customizable feed cost component
- Understand futures / options for market signaling
  - Good way to evaluate forward contracting opportunities
  - Consider for risk management
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