Make Informed Decisions
KevinGrier
Market Analysis and Consulting Inc.

79 Pheasant Run Drive
Guelph, Ontario
N1C 1E4

T 519 823 9868
C 519 240 8779
E Kevin@KevinGrier.com
KevinGrier.com

Alternate Diversification and Risk Management Strategies

By Ron Gietz, Pork Specialist, Alberta Agriculture
December 2017

For most hog producers, price risk management implies forward contracts for hogs and grain, as well as possibly the use of a risk management account which trades in lean hogs, corn, CDN$, and soymeal futures and options. Those are important tools, and arguably the most precise way of managing margin risk, but there are many other tools and methods for managing risk in a hog operation.

Derivatives

Traditional risk management tools can be very effective for stabilizing margins if applied in a consistent disciplined manner, as opposed to a haphazard or sporadic strategy. I would advise any serious producer to set aside time to regularly review packer forward contracts and lock in a portion of production when you are comfortable with the returns. Progressing to the use of a trading account can help capture full margins, rather than just the revenue side. But there is a very real cost in terms of initial and maintenance margins, as well as your own or hired time and expertise to properly manage the account. Thus a trading account is not suited to every operation.

Agri-Stability

Almost every Canadian hog producer would benefit from participating in Agri-Stability. During the difficult decade of the 2000s, the program got a bad rap, as reference margins deteriorated for four or five consecutive years. Criticisms of the program do not take into account that it was never intended to address a major structural shift such as occurred in the mid-late 2000s. For many producers, Agri-Stability worked exactly as intended, protecting them from a severe margin drop in the first year or two and helping to keep the farm solvent.

Integration

Producers have always been interested in investing to move along the production chain, in order to ensure shackle space and capture enticing processing margins. We are currently witnessing an unprecedented hog producer investment in packing in the US Midwest. The results of previous integration investments have been mixed; there have been both impressive successes and spectacular failures. Usually the successes have featured a long term commitment and a business partner or key employee who understands the meat business completely. Another, more common, integration strategy is to invest upstream in a feed mill or even grain production, the traditional mixed farm model.

Stock Market

Integration through direct investment is not always possible or desirable. Instead of starting up a new packing plant, it is much easier to invest in an existing processor whose shares are publicly traded. The only real requirement is cash. If you buy enough shares, you will find yourself cheering instead of complaining when packer margins soar. Going back over the past decade or so, investments in pork packers and "protein" companies have been incredibly lucrative. The best example is probably Tyson Foods, which has increased more than 20 fold since the last market crash, outpacing many of the tech darlings of the stock market.

It is even possible to buy shares in one of the swine genetics companies, which has also been a profitable trade in the past decade. Considering all the new packing capacity coming on-stream in the US, I would probably want to hold off on the stock purchase strategy for a year or two to see how it all sorts out. But definitely take a look at this method of diversification the next time the stock market sees a sharp pull-back.

Ron Gietz can be reached at 403-362-1344 or Ron.Gietz@gov.ab.ca

A version of this report first appeared in the December 4, 2017 edition of Canadian Pork Market Report. If you are interested in a free two month trial subscription to that report, email Kevin@kevingrier.com.