

AN ADDRESS TO THE
AUSTRALIAN COTTON ANNUAL CONFERENCE
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MARKETING COTTON
- selling avenues for the grower

Presented by:

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The Australian cotton grower is in an advantageous position relative to growers of other commodities because there are:

- * no buying monopolies to face
- * free and aggressive competition amongst buyers
- * provisions of special marketing services by co-ops, merchants and larger growers. These are
 - managed marketing via seasonal pools
 - financing of futures and currencies positions via call pools
- * no history of government intervention which has made growers self-reliant and marketing oriented

With this background, what has developed over the past 20 years is an Australian cotton market with many buyers and sellers along with international competition. This has meant that growers are always offered prices for their cotton which reflect the real world market. On top of this, growers are also offered special services such as seasonal pools and call pools, provision of credit and free marketing advice.

Preview

Cotton N.Y. 2mth Fwd Monthly t111 31-May

Merrill Lynch

11300

Oct-69

Oct-72

Oct-75

Oct-78

Oct-81

Oct-84

Oct-87

Oct-90

10300

9300

8300

7300

6300

5300

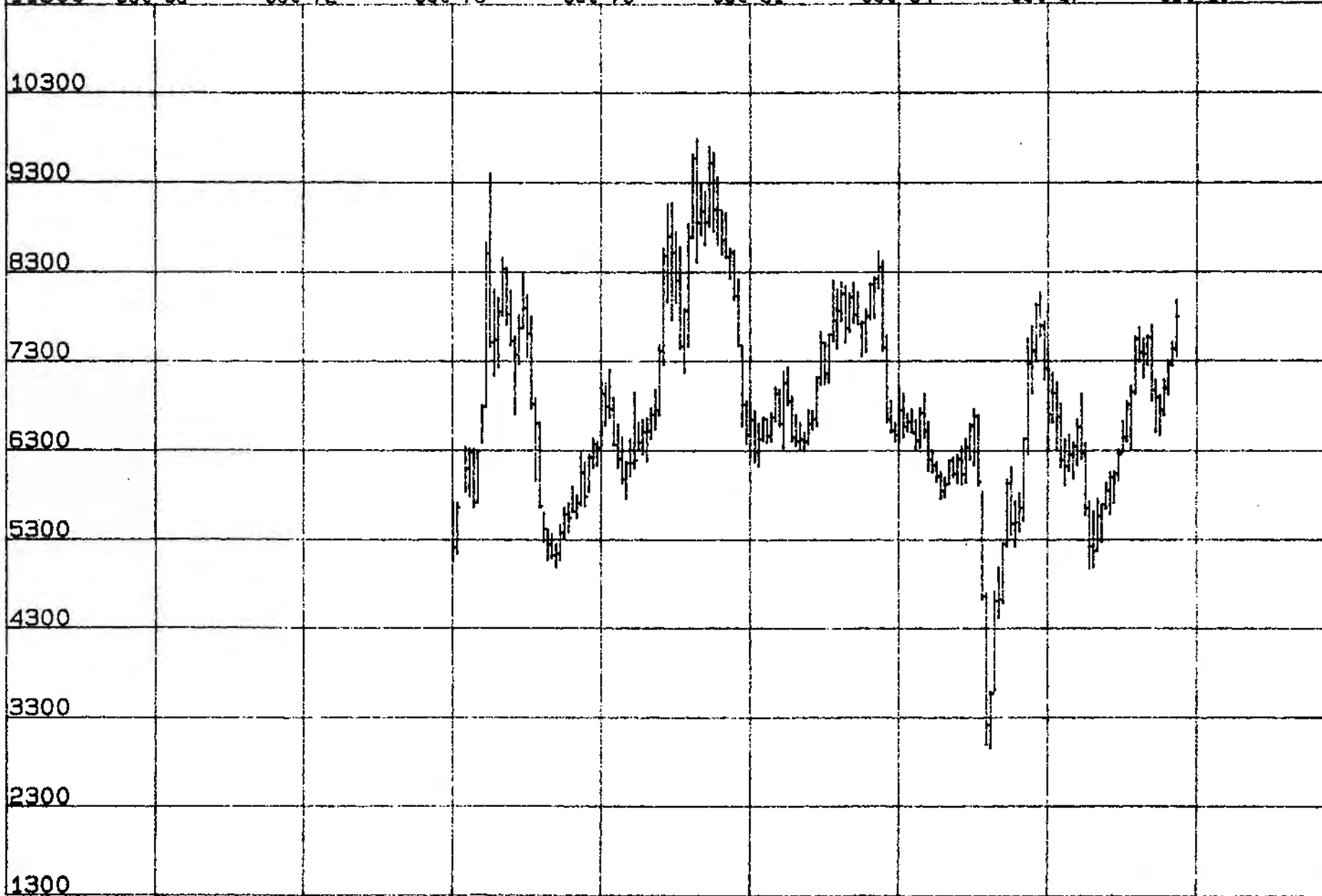
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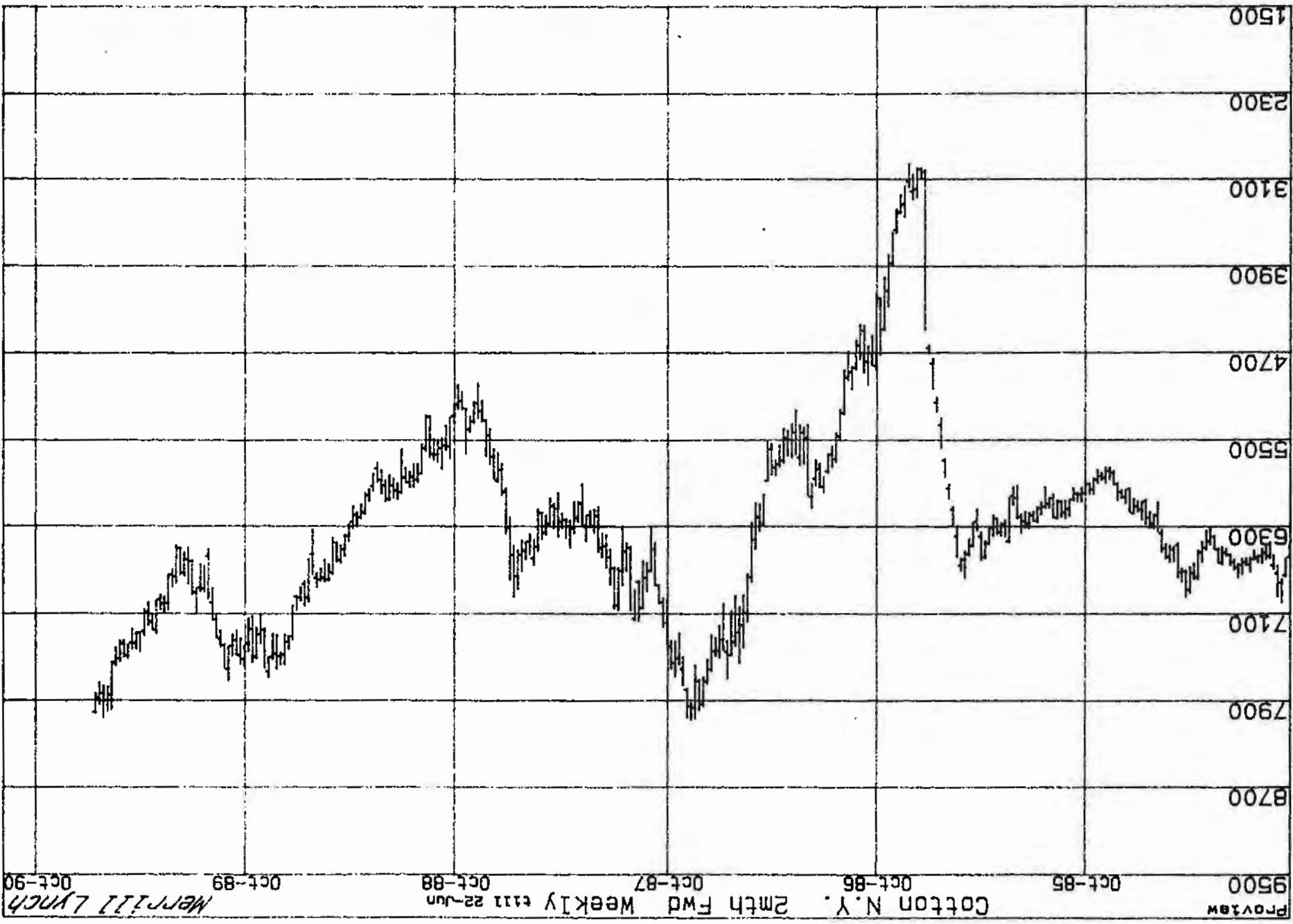
3300

2300

1300

107





Problem

Cotton N.Y. 2mth Fwd Weekly t111 22-Jun

Merill Lynch
Oct-89
Oct-90

Certainly all the assistance that growers can receive when selling cotton must be welcomed in a market that is extremely volatile. On average, over the last 20 years cotton prices have ranged 16 cents over each season. The attached chart shows that in the last 5 years cotton prices have moved from 80 cents to 29 cents. Because of this price volatility growers should be fully prepared to use price strength - sell some cotton when prices are high. Additionally, growers should be able to utilise the array of different selling/pricing methods that are available so as to maximize their profit with the minimum of risk.

It is then up to the grower to use these marketing avenues in the most profitable way.

Some Basics

Remember when selling cotton to:

- * Sell good prices. Do not wait for the highest prices. Greed is not good.
- * Recognise profitable prices.
- * Diversify - some cotton to seasonal pools and some to the daily cash.

- * Forget about what the other bloke is doing.
- * Never listen to merchants, brokers, consultants or any other experts about where prices are going.
- * Know your game - know how to sell your cotton and your currency.

SELLING/PRICING COTTON

For the grower not using seasonal pools the following methods of selling/pricing cotton exist:

1. Sell physical cotton - Australian dollar fixed price (cash offer)
2. Sell futures (call pool) (and if desired buy Australian dollars forward to convert to AUD cotton)
3. Buy put options (call pool)
4. Sell fixed price physical cotton (cash offer) and buy call options (call pool)
5. Sell futures (call pool) and buy call options (call pool). In (4) and (5) call options are often bought into price weakness at a later date.

6. Sell call options (call writing programme)
7. Option combinations - collars (buy puts and sell calls)
 - spreads

These different selling methods should be used to fit different price outlooks. For example, physical cotton or futures should be sold if you view prices as falling, or if you view prices as rallying then the best pricing method is to purchase put options. The following table sets out the selling method to be used for each perceived market condition.

WHEN TO USE WHAT
SELLING/PRICING METHOD

<u>YOUR VIEW OF PRICE</u>	<u>SELLING METHOD</u>	<u>RESULT</u>
1. COTTON PRICES WILL FALL	SELL FIXED PRICE OR SELL FUTURES	YOUR SELLING IS COMPLETE. NO RISK
2. COTTON PRICES MAY FALL	* SELL FIXED PRICE COTTON OR SELL FUTURES <u>AND</u> * BUY CALL OPTIONS	* SELLING IS COMPLETE BUT CALL ENABLES YOU TO IMPROVE YOUR PRICE IF PRICES RISE.
3. COTTON PRICES COULD GO EITHER WAY	* BUY OUT OF THE MONEY PUTS	* DISASTER INSURANCE ENABLES YOU TO SELL ACTUAL COTTON AT HIGH PRICES IF THEY OCCUR.
4. COTTON PRICES WILL GO UP	* DO NOTHING * BUY OUT OF THE MONEY PUTS	* TOTALLY EXPOSED * DISASTER COVER BUT STILL GIVES CHANCE TO SELL ACTUAL COTTON AT HIGHER PRICES.

SEASONAL POOLS

The "managers" of Seasonal Pools use all the above selling methods. They will sell futures to hedge against falling prices, sell call options to earn premium, buy put options to establish minimum prices for the pool. Also they will sell forward your actual physical cotton. At times, if prices look like rising from the levels where your physical cotton has been sold forward then the Pool Manager may buy call options. At times as well, the Pool Manager may instigate option combination strategies; a common one being buying put options to establish minimum prices, but at the same time selling call options. Selling the call options pays for the purchase of the puts but establishes a ceiling.

BACK TO REALITY

Prices today (June 25) are excellent for next years crop. May 1991 futures are at 75 cents and you can sell cotton today for next May at 480 net. Everyone feels prices will go higher. The talk is about heat and dryness in West Texas with some 700,000 bales disappearing. Can prices go to \$550? Why sell a market that looks so strong?

A selling strategy:

1. Commit 50% of your cotton to seasonal pool and market the remaining 50% yourself. This achieves some diversification.
2. Sell 1/2 bale an acre for delivery next year at AUD480.
3. Buy put options, strike 72, and sell call options, strike 78, on March futures. Zero cost. Do this for 1/2 bale an acre. If the market collapses you have a minimum US price of 72 c/lb. If the market rallies you will be short futures at 78 c/lb.
4. Leave 1/2 a bale to sell after ginning.

SUMMARY

The cotton grower is well serviced by competitive cotton buyers. The variety of selling methods available to the grower go a long way to underpinning the continued expansion of the Australian cotton industry.

