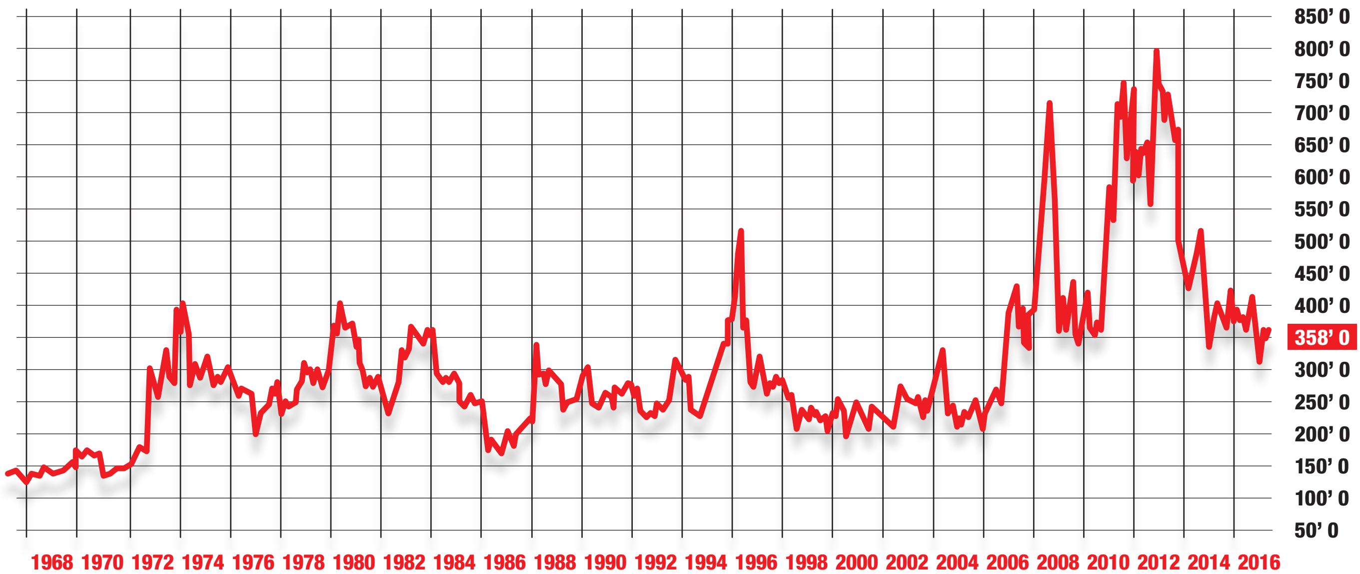
YOUR PROFIT

By Al Kluis

CBOT Corn Monthly



This is the long-term monthly chart of CBOT corn futures prices. You can see the last major lows in 1985, 1992, 2001, 2008, and most recently September 2016. This chart shows that prices don't stay at extreme highs or lows for very long. It also shows that the long-term cycles for corn and farm profits all turn higher this year.

LONG-TERM FARM PROFIT ANALYSIS

A LOOK BACK HELPS YOU LOOK AHEAD TO THE NEXT DECADE.

Farming is a very long-term business. How you position your farm for the decades ahead is key to your success – and your survival. Let's look at the next decade and make some projections. But before looking forward, it's important to look back and learn from the ups and downs in farming over the last 50 years.

A LOOK BACK

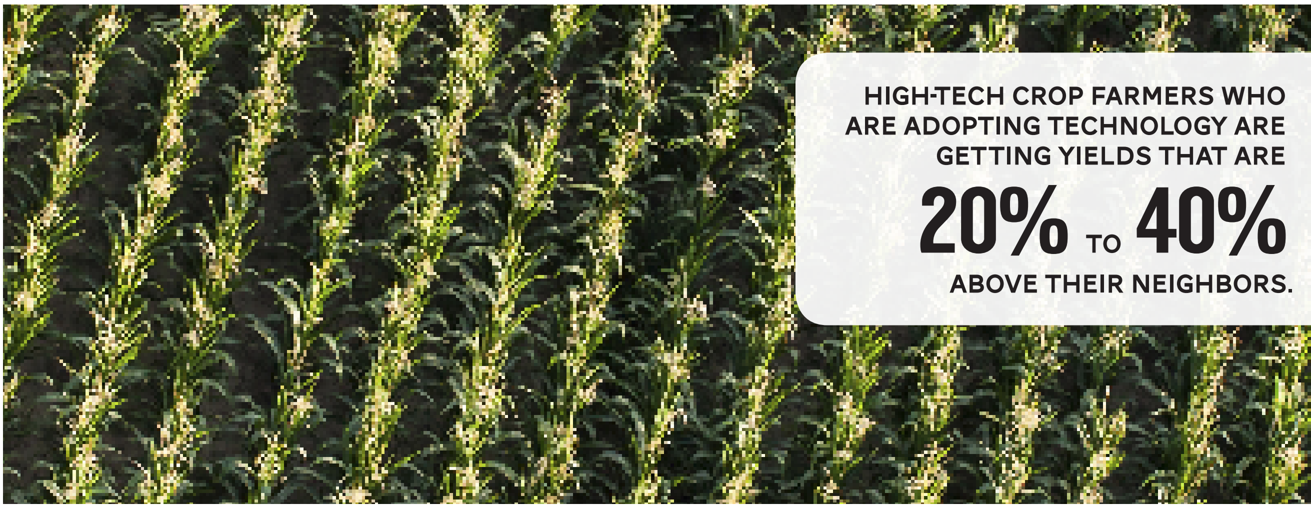
The 1970s: Farm prices and farm profits were gradually increasing. Farmers were using more commercial fertilizer and better seed. The USDA farm programs required set-asides. The major marketing factors each year were changes in USDA loan rates and USDA target prices. One of the keys to keeping your farm profitable was how well you were positioned in the farm program. Inflation increased each year and so did costs. This meant farm profits were hard to come by. The increasing inflation rate was not just a problem for agriculture; it was a major economic problem for the U.S.

The 1980s: When President Reagan was elected in 1980, he promised major changes. He also promised to slow down inflation. He did succeed in slowing inflation – and how! It was painful. Interest rates were ramped up. The prime rate peaked at 20% in April 1980. The U.S. farm program was changed, and the new Freedom to Farm policy eliminated set-aside programs and increased planted acreage. With the higher interest rates, the U.S. Dollar Index soared to 164 in 1985. Farm prices and profits were hit hard. Land prices dropped by 50% to 70%. This created the Great Farm Crisis, which hit rock bottom in 1987. After several years at the bottom, farm prices finally started to turn around by 1990.

The 1990s: This decade was a welcome time of rapid growth in farm productivity and huge growth in global demand. Farmers who had good crops and sold them at the right time made good returns. By the late 1990s, after several years of good crops around the world, prices and profits started to fade. Prices and profits put in a major low in 1999.

The 2000s: In 2000, George W. Bush was elected president, and global trade and export demand both kicked into high gear. It seemed like no matter how big the crops were, they got used up. Then came 2008 and the financial meltdown. The stock markets – as well as farm prices and profits – dropped, and then they bottomed in 2009.

The 2010s: After the 2009 low, prices and profits went sharply higher for the next four years. A major high developed in the grain and land markets in the third quarter of 2013. The four years up were followed by four years down. Prices fell from 2013 through early 2017. The U.S. went through nearly a decade of zero interest rates and slow economic growth. Many in the U.S. and the free world began questioning the



benefits of free trade and globalization. In June 2016, voters in England shocked the world when they voted to pull out of the Euro. Five months later, in November 2016, voters in the U.S. shocked the world when they elected President Trump.

It's early on the calendar, but I think the next decade has effectively started. The economic and structural changes that are being proposed in Washington, D.C., are huge. There will be major structural changes. The changes that are being proposed by the new administration are likely to have the most dramatic impact on your profits since President Reagan was elected 37 years ago in 1980. I think it's going to be just the opposite of 1980, though. These changes will create a wave of inflation. I am optimistic about prices, but I'm concerned with profits.

A LOOK FOWARD

Here are my initial thoughts of what to expect and how you should position your farm for the next eight to 10 years.

Prepare for inflation. Since November, short-term borrowing costs are up ½%. Long-term rates are up nearly 1%. Crude oil is up over $10 per barrel, and gasoline and diesel prices are up 20¢ to 30¢ per gallon. With the major infrastructure program that is likely to get approved this year, the cost of iron and farm equipment will also move higher. Put together a plan each year for locking in inputs ahead of time.

Manage your margins. I expect grain prices to move higher by late 2017 and still higher by 2018. This will not create better bottom-line profits for your farm unless you manage input costs. The cost of inputs hit a major low in 2016. I expect all costs to begin to increase along with inflation starting in 2017 and continuing for the rest of the decade.

Maximize your income. We are entering another decade of huge gains in productivity driven by technology. High-tech crop farmers who are adopting technology are getting yields that are 20% to 40% above their neighbors. These same farm businesses have other team members who focus on risk management and marketing. They are selling 20% to 40% above their neighbors. Even in low margin years like 2016, they are turning an operating profit. When prices turn higher, they will be in a great position to maximize those gains.

If your farm team does not embrace new technology and develop risk-management and marketing skills, your farm operation may someday be run by a team who does.

Invest in your team. It takes money and the right team members to adopt and adapt to the new technology. I know it is difficult to write out that first check; however, the alternative of not adopting the new technologies is to get left in the dust.

The same is true for marketing. You can hire a good adviser to work with, but the real long-term solution is to have a team member who really knows how to market. Again, it takes time and money.

Don't forget about the emotional risk. You have to learn how to work with a team, trust team members to pull their weight, communicate, and share the good and the bad. Know that your team is one of the best investments you can make for the long-term benefit of your farm.

NOTE: Trading of futures and options has substantial financial risk of loss and is not for all investors.

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Al Kluis has been trading grain futures since 1974. Sign up for a free trial to his daily morning email and weekly "Al Kluis Report" by going to alkluis.com.

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