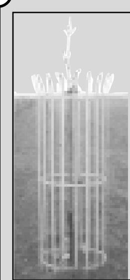
WOODLAND & TIMBER

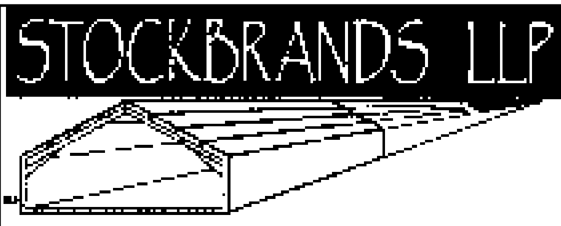


TREE GUARDS
UNIQUE LANDSCAPE COLLECTION

Protect your trees from cattle damage.
Agricultural & Domestic Use.
Supplied Natural Finish or Galvanised Steel.
Full range of sizes available.

For further details tel: 01440 712895
JW LOWRY ENGINEERING
Unit 4, Homefield Road, Haverhill, Suffolk CB9 8QP

BUILDINGS

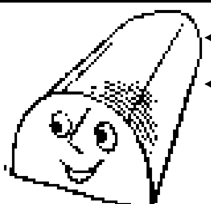


Working with you to choose the right solution...
Specialists in Insulations & Cladding Products & Services

Sprayed Foam Insulation • Insulation Boarding
Sound Insulation • Roofing Solutions
Building Renovation • Overcladding

tel 01986 781342 • fax 01986 781207

www.stockbrands.co.uk
Oaklands Yard, Flixton Road, BUNGAY NR35 1PD



✦ BARNS RE-CLAD
✦ STEEL CLADDING SUPPLIED
• Box profile - straight
• Corrugated - Curved

BUSSENS & VIGRASS
Tel: 01366 382294 Fax: 01366 382878

CONTAINERS

CLASSIFIED ADVERTISING
CALL CHARLOTTE ON
01986 834252

Time Value – are you getting it?

If you cancelled your car insurance half way through the year, you would expect a rebate. The same is true of Options, writes **Jeremy Cole**.

There was a change to the grain marketing world this month. No, it wasn't an end to volatility, the creation of a single UK Wheat Board or a minimum £100 harvest. It was the ability to obtain Time Value on an Option trade. Fantastic you may say, but what is it?

It is nothing to do with Dr Who, Captain Kirk or H.G.Wells, but everything to do with flexibility, choice and an even greater ability for farmers to forge their own destiny, regardless of the vagueries of the grain market. It involves setting guaranteed minimum prices or a 'Standard of Living Line'. To achieve a pre-agreed gross income is now even easier and more cost effective.

This is a fundamental change to the flexibility of Options. It has always been part of the way Options work but not freely available from the trade. This is going to be a real benefit to farmers that already trade Options and those that felt they were previously 'too expensive'.

Time Value allows some value to be retained in the premium even if the Option is not making any money. Fantastic! Previously it was thought that the Option would have no value and the premium forfeited. This is why some farmers shunned them with a premium of £5-£8/t, as the downside was seen as too great. Farmers in general feel that a 5% insurance spent is the limit.

So from now on, if Time Value is not offered, don't set up the Option with that person, as it will damage your wealth.

Think of this concept like car insurance. If your car were sold half way through the year, you would expect the insurance company to rebate some of the policy, even if the car had not crashed. The same is true of Options.

The Time Value of an Option is always positive and declines exponentially with time, reaching zero at the expiration date. Prior to expiration, the change in time value with time is non-linear, being a function of the Option price.

In general, the Time Value of an 'At the money' Option only falls by 50% over the first 3/4s of its life, so long as the spot price remains the same as it was at the outset. The further the spot deviates from the original Strike Price, a price fall with a Call Option, the faster the time value will degrade. However, a £5 price fall in the first month would still only lose about £1.50 from an original Options premium of £6, as the Time Value is still great, because 11 months are left until expiry. The Option would be sold back, if the fall was believed to be part of a larger decline, and £4.50 'rebated'. Under normal rules, the total £6 would be at risk until expiry.

So an initial Option premium for a year ahead may be £5/t, but if the spot price goes against the Option, i.e. down with a Call Option, the Option can be sold back, and some time value 'rebated'. This means the NET premium eventually paid can almost be pre set, even though the initial premium was higher than desired. This means the cover is there for the time you need it, and removed at any time, when its job is done or a change in market direction looks likely.

This is particularly useful for Options taken out along way ahead, such as Nov 08, when the initial premium is £7-8/t. The Time Value degrades really slowly, pence per day, so in a year's time it will still have most of its value.

This premium is perceived by some as too much and the Option is declined, no cover is taken and the sale is not hedged. However, with Time Value, if the market adversely deviates from the original level, the Option is sold back. So the NET premium can almost be pre-determined and becomes what you originally wanted/wished it to be, £2, £3 or £4/t or a percentage of the gross crop value. If the market goes with you get the difference and claim on the 'insurance' as normal.

This means that Options are now even more flexible, at an eventual net premium you decide from the start. Just set a stop-loss price from the outset, of say £2-5 deviation from the original Strike price. Bale out, collect a 'rebate' and move on.

There should now never be any farmers feeling they have lost £5-7/t from the Option insurance if they don't 'claim'. Many more farmers should now take the opportunity to try or increase their use of this versatile hedging tool, as the 'too expensive' argument no longer exists.

For more info, please ring me – or better still, come on a training course.

Jeremy Cole, Bsc Agri Econ (Reading) has run Agricole, since 1993. It is an independent grain brokering and marketing service for farmers, offering a weekly grain market report. For details, call 01954 719452.