

Agricultural markets

The art of separating finance and feelings

Alarm bells should ring out in the finance markets when »soft factors« mix with bad financial news out of the US and Euroland. Such soft factors comprise the psychological and emotional reactions that actually amplify market trends and therefore have a real effect on prices. In recent weeks the agricultural commodities markets have mirrored the finance market trends and suffered definite losses. Following the price-slide after Standard & Poor's downgrading of US credit worthiness in week 31 the question

is not whether prices will drop in the agricultural market, but how much. In the 2007/08 financial year markets for agricultural products were almost unbeatable for volatility, triggering soaring grain prices. Now we're near a change in direction. Since summer 2010 agricultural commodity markets have experienced a new volatility. Following this spring's record 2011 wheat contract price for harvest (240 €/t), prices are now slipping back and the signs point to the next phase in the opposite direction.

Agricultural markets are subject to greater price fluctuations than others because crop-growing conditions mean harvests vary from year to year and from region to region.

Agrarmärkte sind größeren Preisschwankungen ausgesetzt sind als andere Märkte, denn die Erntemengen variieren von Jahr zu Jahr und von Region zu Region.

Les marchés agricoles sont soumis à de plus fortes variations de prix que les autres marchés car le niveau des récoltes varie d'année en année et de région en région en fonction des conditions de culture.

Price fluctuations higher. People are talking about speculation in the commodity futures exchanges. Political opinion is that this heats up price developments. Basically, it's fair to say that the agricultural markets are prone to greater price fluctuations with main influence hereby the amount of production. Harvests vary from year to year and from region to region though biological and climatic conditions during growth. Weather, catastrophes and crop pests can threaten harvests worldwide. The production process for farm commodities takes time, so supply cannot be adjusted to prices short-term: demand and supply elasticity is relatively small. This is why price variations are marked – so that following a supply shock, especially when availability is limited, supply and demand find their way back to balance.

The factors behind commodity trends. The factors behind agricultural com-



modity price development are the fundamental ones. A major influence is the supply situation. Basically, if the harvest year prognosis indicates that grain availability may be low, then prices tend to rise. If supplies are built up again, prices tend to drop.

Supply and demand depend on a series of factors. For instance the great drought of summer 2010 in Russia led to an export stop which in turn precipitated a massive price increase. Additionally, wheat and maize prices react strongly to changes in the availability and in consumption ratio (e.g. more supply means prices tend to fall).

The role of commodity futures exchanges in this respect is increasingly discussed. The World Food Organisation (FAO) says that trading in the commodity futures exchanges has intensified price volatility, although on a short-term basis only. Long-term, the price is decided through real trading, where selling and buying of physical ware reflect and determine the fundamental strengths of supply and demand. From this aspect, we can expect price volatility for agricultural products to continue for a while because supply is low this season, as is the supply-consumption ratio.

A visit to the psychotherapist? What's the current problem? After all, what we call the fundamental data can be measured, classified and evaluated. So there's no place for panic according to the old laws of the market. Big supply: small price. Small supply: big price. But listen to the statements increasingly voiced. Opinions such as: »There's no real justification for wheat's weak price«. Here's where market psychology pops up – in agricultural markets too. Maybe the market should, now and again, visit a psychotherapist. These very words were voiced recently by an Austrian financial



journalist on the theme market psychology. This probably won't happen. Because in every market situation there is an opposing force, usually making money out of the position.

The psychology of market decisions. But if the market won't visit the psychotherapists we should do some self-analysis. A remarkable fact: humans repeatedly fall into the same behaviour and perception patterns when faced with risk situations. Scientists have established this in experiments – and it applies to farmers too. Accordingly, we orient ourselves not on the end sum, nor the initial one, but on relativised losses and profits. Hereby losses make much more impression than gains. The losses »felt« are around double the »real« losses. This is confirmation of the old trading proverb: »Nothing hurts more than missing the chance of a profit«. But there's more: people tend to excessive self-confidence. They think they are better than the average. Such self-assessment means they try to get more out of the market. How would this apply in the falling grain markets we are

Opinion forming is one side of the coin, herd instinct the other. Even professional investors are not immune to the latter and this creates wonderful humus for financial bubbles.

Meinungsbildung ist die eine Seite der Medaille, der Herdentrieb die andere. Davor sind auch professionelle Anleger nicht gefeit, und das bildet einen wunderbaren Humus für Börsenblasen. D'un côté il faut se faire son opinion, de l'autre, il s'agit de conduire son élevage. Les investisseurs ne sont pas plus malins que d'autres pour faire les bons choix. Cette situation constitue un terreau idéal pour la naissance de bulles financières.

experiencing just now? Instead of selling early-on, the highest price is still followed, waiting for the market to turn. Result: margin continues to be reduced. The situation gets even more drastic when losses are not realised in an early stage. Because if the position is allowed to run on, losses are only further piled up, a direct result of refusing to admit defeat.

This is a mind-set that has the market participant often reluctant to take risks when in the profit zone whilst willingness to take chances rises in the loss area, an effect intensified with many by poor assessment of probabilities along with a tendency to overvalue new information.

Following the herd instinct. How good is our perception and assessment of information? First of all we have to realise what psychological effect information can have on the individual market participant. Logically, seller and buyer must have access to completely different information. After all, one party thinks the situation is just right for buying. But another believes that exactly the same situation means it's

time for selling. The same facts: completely different interpretations.

Opinion forming is therefore only one side of the coin. Herd instinct is the other. Not even professional investors are immune to this and it represents wonderful humus for stock market bubbles. Even with decisions that are identified as poor it's difficult for individuals to evaluate the problem and take appropriate action. This is because, as individuals, we associate a much higher risk in acting alone, much higher than that of simply joining the herd all making the same mistake.

But the personal psychological repair kit has another tool for fine tuning own judgement and making it more acceptable. When moving onto thin ice, justification for actions is often sought in the media or market reports whereby only the positive points supporting own decisions are picked-up. A further effect is that this subjective perception is intensified as it's passed on down the information chain

and into the market. This is why assessments by participants with their own position in the market are always influenced by subjective perception.

A discipline of capital market research established a few years ago in the US, behavioural finance, studies these decision structures, the behavioural economics of business decisions. Starting point for study is the knowledge that market participants react illogically and repeatedly fall into rationality traps.

However, behavioural finance is in no way a method of foretelling the stock market or exchange. It's more involved in analysing the art of separating finance and feeling, improving knowledge of behavioural patterns and through this helping to avoid judgement errors. The important thing, say the finance experts, is to face the decisions of the moment, completely detached from what has gone before. »Only the present counts.«

Mechthilde Becker-Weigel
DLC market expert

Nur die Gegenwart zählt! Für Marktentscheidungen gilt, dass diese vollkommen unabhängig von früheren Entscheidungen getroffen werden müssen. Gefühle dürfen keine Rolle spielen, denn die Preisbildung für Agrarrohstoffe hängt an handfesten Faktoren. In erster Linie ist das die Versorgungslage, die sich aufgrund der Dauer landwirtschaftlicher Produktionsprozesse nicht schnell anpassen lässt. Das kann zu starken Preisschwankungen führen.

Seul le présent compte ! Cela signifie que les décisions concernant les marchés doivent être prises sans tenir compte de choix précédents. L'émotion ne doit plus jouer aucun rôle car le prix des matières premières agricoles dépend de facteurs strictement définis. En premier lieu il s'agit de l'approvisionnement des marchés, un élément qui évolue lentement en raison de la durée du processus de production agricole. Cela peut conduire à de fortes variations de prix.

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