POWER*HOUR*
MARKETING DISCUSSION

Stewart-Peterson
Analysis. Advice. Action.

Question:

What happens if the PPD (Producer Price Differential) goes negative and I locked my milk in based on the Class III futures but over 30% of my blend price is Class I fluid? Was my decision to forward contract still a good decision? Are there strategies for protecting myself against the rare case of a negative PPD messing up my marketing plan?

Answer:

A negative PPD is never fun to see on a milk check. A negative PPD occurs when the Class III price outraces the Class I price for a given month. The Class I price is usually set about three weeks or so before the Class III price is set, which is what allows for the pricing discrepancy. There really is not an ideal way to guard against a negative PPD.

A negative PPD typically indicates that the market is moving up at a very fast rate, which is usually a good thing (often, this type of moves occurs during the bottom of the milk price cycle). In theory and practicality, if you receive a negative PPD on the way up, some or all of that deduct should be given back when prices head down in the future.

A call option may be able to help, yet, to always have a call option in place to protect against a rarely occurring negative PPD is a long-term losing proposition. Purchasing call options on contracted milk may help if you are at the bottom of the milk cycle or after a big selloff. The key is to identify those depressed price areas and then purchase call options – something that is easier said than done.

We recommend that your develop price strategies with a long-term horizon and manage price consistently over time. Planning ahead of time and implementing marketing tools when appropriate – such as futures and options – can help position you to capture price opportunities and manage risks, such as a negative PPD.

137 S. Main Street, West Bend, WI 53095 | 800.334.9779 | phone 262.334.9779 | fax 262.334.6225 | www.stewart-peterson.com