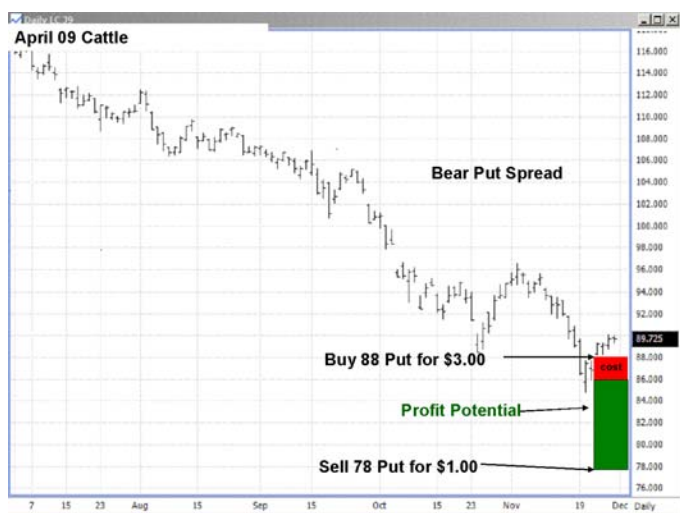




The example is buying a \$92 cattle call and selling a \$102 cattle call in the same month. By selling the \$102 call you are reducing the premium or cost of the trade while still having the opportunity to gain on a \$10 per cwt less premium cost. The cost is determined by the premium of the \$92 call minus the premium of the \$102 call. This strategy can be used by producers wanting to re-own inventory or by someone expecting a potential rally.

**Bear Put Spread:** Establishing a bear put spread involves the purchase of a put option on a particular underlying futures contract while simultaneously selling a put option on the same underlying futures contract with the same expiration month, but with a lower strike price. Both the buy and the sell sides of this spread are always the same number of contracts. This spread is sometimes called a "vertical put spread". The bear put spread, as any spread; can be executed as a "package" in one single transaction, or as separate buy and sell transactions. This transaction is used in a moderately bearish to bearish bias.

A hedger often employs the bear put spread in moderately bearish market environments, and wants to capitalize on a modest decrease in price of the underlying futures contract. If the producer wants to protect his production in a very bearish outlook it will generally prove more profitable to make a simple put purchase. However this spread can be established to either reduce cost of purchasing and holding the long put position alone, or when unsure of bearish market opinion.

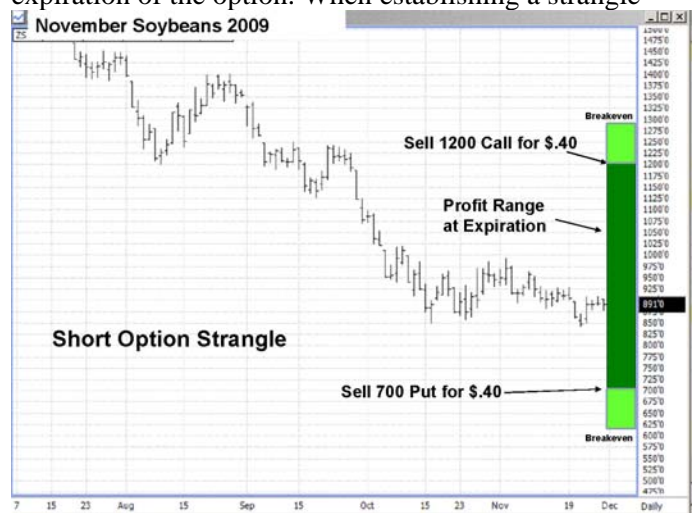


The bear put spread provides risk protection for the crop or livestock produced however it is limited to the difference in strikes minus the cost (difference in premium prices). The chart depicts the area where price protection is placed on the downside. If market moves higher the producer benefits as cash assets improve in value. The proprietary software program (Allendale

Evaluator) can be used to assess the benefits of the bear put spread to your revenue per acre or cost per head for livestock producers.

**Short Option Strangle:** The Short Strangle strategy involves selling the call option and the put option at different strike prices in the same month of a futures contract. When entering a Short Strangle position, a hedger will sell an of out-of-the-money call contract while simultaneously selling the same number of out-of-the-money put contracts for the same month and same futures contract. The Short Strangle position has a set maximum profit and potentially unlimited risk if the futures contract moves against you.

Since you are selling options there is a net credit achieved when the position is opened. The maximum profit for the position is equal to the net credit. The maximum profit is realized if the futures are trading between the strike prices at option expiration. By selling both a call and a put there is both an upper and lower-break even (as depicted in the chart). There is risk if the futures move quickly in one direction. The optimum time to establish this position is when it is anticipated that the underlying futures are expected to trade sideways into expiration of the option. When establishing a strangle



position, it is important to analyze the specific underlying futures market for fundamental issues, seasonal patterns and volatility patterns. Contact your Allendale broker or the Allendale Research Center for details. The net profit in this position is calculated by adding the credit from the sale of the put and the call. In the example on the chart, the seller receives \$.80 if the futures close between \$7.00 and \$12.00 at option expiration. The seller will receive a portion of the \$.80 if, at expiration, the futures close between \$12.00 and \$12.80 or \$7.00 and \$6.20. The risk in this position comes if the underlying futures move sharply in either direction then additional margin requirement may be needed. It is suggested to have an Allendale Broker run the Allendale Evaluator to assess the benefits to your marketing plan.

**Covered Calls:** Selling calls against a long cash position can be an excellent way to generate income. This is an options strategy whereby a producer holds a long position in an asset (corn, beans cattle or etc.) and sells call options on that same asset in an attempt to generate increased income for the asset. This is often employed when a producer has a short-term neutral view on his product and for this reason holds the cash asset and simultaneously has a short position via the option to generate income from the option premium. Or if the producer is holding cash assets but concerned about delivery, selling an option could be used to generate additional revenue during the process. The following chart diagrams the benefits of this strategy. In November



beans of 2008 an \$11 call was sold for \$2.00. If November futures closed below \$11 on option expiration day, the producer keeps the \$2 per bushel or \$10,000 per contract. If the futures closed between \$11 and \$13, the producer would keep a portion of the premium received. A close above the \$13 could be treated as a sale of soybeans at \$13.00. This strategy provides the producer many different alternatives and ways to increase revenue on his/her production assets. By holding the assets, selling the call minimizes the hedge though it may not limit the margin requirement.

**Allendale 3 Way:** This strategy uses a combination of the bear put spread and the covered call positions. As depicted in the chart we are boxing in a window of opportunity by purchasing an at-the-money or near-the-money put, selling an out-of-the-money put and selling an out-of-the-money call. The objective of this strategy is to provide downside risk protection on cash assets while leaving a window open for a higher sale price for assets.

Additionally this strategy minimizes the margin requirement needed to hold the position in a commodity account while limiting the cost of the strategy. As shown in the chart below, the user of this strategy has a floor price of \$4.20 less the \$.10 cost or a net floor of \$4.10. If the market drops to \$3 (in dark green) the option will provide the revenue protection. If the futures price, at expiration, is at \$5, the option will have only cost \$.10 and the cash asset will be providing the increase revenue. This is a more complex strategy which the Allendale Evaluator Program can be used to explain and project the returns on a per acre or on a per animal basis.



**Conclusion:** We have shared 5 different option tools which can be easily added to your marketing toolbox. These tools can be designed to reduce option premium cost and or increase revenue while managing risk. It is recommend to monitor these positions closely as there may be times when moving from one strategy to another can be advantageous.

**Call an Allendale representative at 800-262-7538 to set up a personal marketing meeting at your convenience.**

**You can email us with question at [research@allendale-inc.com](mailto:research@allendale-inc.com).**

**For specific Corn, Soybeans, Wheat, Cattle and Lean Hog price projections call or email Allendale's Research Department.**

Hypothetical performance results have many inherent limitations, some of which are described below. No representation is being made that any account will achieve profits or losses similar to those shown. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses or adhere to a particular trading program in spite of trading losses are material points which can adversely affect actual trading results. There are numerous other factors related to the markets in general or to the implementation of any specific trading program which cannot be fully accounted for in the preparation of hypothetical performance results and all of which can adversely affect actual trading results.