Section 4

Flour Millers' Use of Futures Markets

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The Use of the Commodity Exchange by Millers

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Milling—A Basic Food Industry

. . . To tell you about the miller's use of the commodity exchange, I first would like to tell you something about the flour milling business. Milling is an ancient and honorable profession. Some historians tell us that it is the world's second oldest profession! It is a large and basic industry—an industry of relatively few people—an industry requiring heavy machinery and heavy application of power per worker. An industry of overcapacity. An industry beset with all the trials and tribulations brought about by rapidly changing eating habits of the American people. A business characterized by seasonal and impulsive buying. It has been and probably always will be a highly competitive industry—an industry existing on small margins. This brings us to the point where I would like to bring into our discussion the miller's use of the grain exchange.

We like to think of organized grain exchanges not only as the exchanges themselves, but as the whole complex surrounding and including the grain exchange and its members. We include in our thinking, facilities provided by the wire houses—the market letters, the private commentaries, and the scholarly analyses of individual members. In the largest sense, these and many other factors are part and parcel of the organized grain exchange. I will speak generally in that meaning. After all, what would the trading floor mean without the traders? The grain exchanges are more people than they are trading facilities—tickers, teletypes, rules, and chalk marks. These people, being subject to the rules, are a part of the exchanges, and their mimeographs—private wires and branch offices are just extensions of their personalities to broader fields.

Grain Exchanges Provide Many Services

The organized grain exchanges have developed side by side with the flour milling industry. Each has shaped its growth and development to fit or to fill the needs of our ever-changing economy. Without the grain exchanges, the milling industry could hardly operate.

The grain exchanges:
1. Collect and disseminate rapidly the vital statistics on a worldwide scale—
a. Crops and crop conditions
b. Political developments
c. Pertinent financial information
2. Supply expert opinion and commentary on developments affecting grain
3. Provide leadership and a vehicle for common action on matters of joint concern to millers and grain men in such matters as freight rates, government bureaus, state regulations, etc.
4. Provide a place where grain may be bought and sold under sound rules
5. Provide facilities for grading and testing grain
6. Provide a marketplace for trading in the future delivery of grain
7. Provide machinery for instantly recording transactions and instantly disseminating these transactions to interested parties everywhere
8. Provide facilities for binding the markets together by direct wire services

Marketing Efficiency at Its Peak

In summing up all these items, it seems to me, that millers and the grain exchanges head up a marketing system, the efficiency of which cannot be matched the world over. In commenting on the services the grain exchange provides, I believe it is well to stress the important fact that the grain exchange brings together in one central point the means of expression of the many factors that go toward making a market. By so doing, it is impossible to have distorted quotations of value for an indefinite or prolonged period without corrective action taking place. By providing a means for reflecting minute-to-minute and hour-to-hour quotations it greatly speeds up the process whereby distortions in value can be corrected. This is of considerable worth to both the producer and the consumer, because it does not permit prolonged price distortions either on the high side or on the low side. The grain exchange permits all the market factors such as weather, crop conditions, political and international incidents, and all other factors affecting supply and demand to be rapidly digested and quickly reflected in the price level of any commodity. All the above factors are particularly applicable to wheat, because the size of the crop and its wide usage permits a broad market.

With the facts we have highlighted regarding the grain exchanges and the flour milling industry, I would like to take you behind the scenes and let you have a glimpse of the office of my company for a day during an active flour selling period.

An Example: The Miller Uses the Market

The time is the latter part of June, the winter wheat crop is moving to market—the place, the Minneapolis Office of Commander-Larabee Milling Company where sales are handled for our six flour mills. Buyers generally have shown interest for several days. A few leaders have bought flour, and the rest of the trade can be expected to come in if the market holds or shows strength. We start the day with an even wheat position—we are neither long nor short wheat. Our salesmen have been alerted and have been contacting buyers of all kinds.

The first trade comes in over the telephone before the opening of the market. It calls for a few thousand bushels of soft wheat to grind flour for a cake baker. Our Grain Department is posted, within seconds, of the necessity for buying the wheat. Our buyers are not instructed to buy on the opening, but to use their own judgment as to what moment to buy, in what market, and in what future. The choice soft wheat necessary to fill the order will be bought later as it becomes available on the cash tables of the exchanges.

By this time, overnight reports from the wire houses are available and special reports are coming in over the tickers. The market opens up ⅜ of a cent, and moves up to ¾ of a cent over the previous close. There is one particularly large trade in the making and a telephone call is placed for the buyer. He will be particularly interested in a report relayed from one of the grain exchanges regarding rust in an important wheat growing country. He will also want to discuss the implications of a large purchase of wheat made by a foreign government.

Cash Wheat Covered by Futures Contract

Meanwhile, trades are coming through on family flour calling for low protein winter wheat, on semolina calling for durum wheat, on high protein spring wheat flour—and this *big* deal, still pending, is for hard winter wheat baker's flour. As each trade comes in, it has been covered by a futures contract purchased within minutes by our Grain Department, not in durum wheat, not in soft wheat, not in low protein or high protein spring or winter wheat, but in the futures market, in September wheat, in December wheat, in Chicago, Kansas City, or Minneapolis.

During this time, our Grain Department men on the exchange floors have been looking over samples of wheat there. Several cars have been bought and, of course, on these, hedges have been lifted. Many more cars which meet our milling requirements of the day will be bought before the session closes.

Now, back to our *big* deal: The buyer is not ready to talk. This is really a large trade and will involve many hundreds of thousands of bushels of wheat. It may develop today—it may develop tomorrow—or, it may not develop for us at all. A competitor may get it. If we get the order, we will want to cover the wheat quickly to avoid loss. We can only do this by using one or more of the grain exchanges. It should be pointed out, even though I have mentioned it before, that these exchanges are only seconds apart, due to wire inter-communication. This tends to move the markets more or less in unison. More information comes in regarding the rust reports, and a government agency makes public an official report which is flashed to the grain trade by private wire houses. A foreign dispatch reports a country, which is normally an exporter, as buying wheat. Another report has Holland refusing to buy our flour, because we won't buy her cheese. These reports are winnowed and condensed and passed on to our sales force, or to the buyers as they come on the telephones.

More trades come in. A cookie manufacturer buys. This deal calls for more soft wheat. A Cuban baker buys bread flour, which requires high protein spring wheat. An exporter buys clear. Each sale requires purchases on the grain exchanges. Each trade is almost instantly accomplished, and at practically unchanged figures. Despite this buying on the part of our company, and on the part of many other milling companies, the market is able to absorb the flood of buying and remain on an even basis, up only fractionally from its close of the day before.

But *the* big trade might be a little harder, and it hasn't come through. The buyer is not yet ready to talk. Other trades continue—a Southern baker, an

Eastern flour jobber, a cereal manufacturer, a Midwest baker, and another, and another—all good round lot sales. Each is relayed to the trading floor, each sale is covered quickly and easily.

And now *the* telephone call from the *big* buyer comes through.

"What do you think of the market? What new information do you have from the grain trade? What private information do you have on the rust situation? What do you think of the announcement by the Department of Agriculture?"

Our buyer is right up with us on his information. He too has a pipeline to the data gathered and broadcast by the grain exchanges. All angles of the trade are discussed—quantity, grade, price, time of shipment, and then the big question. . . .

"Is now the time to buy?"

"It's up to you, Mr. Buyer, but here are a couple of items that have just come in. Another rust report 50 miles farther north than the last one; and India will buy several cargoes of wheat over night."

"Well, let's trade!"

It's a deal. Small talk continues for a few seconds, and then the conversation is over.

Our grain people had been previously alerted and a course of action determined. Word is passed to them and the process of covering this large transaction on the grain exchange starts. I pace the floor and get reports: A quarter is covered at unchanged figures, a half is covered at ⅜ up, more is covered at ½ up—and finally, it's all covered at a fair average. It's routine—it happens every day, but the margins are so thin that a fluctuation of even a fraction of a cent per bushel in covering a sale may cut the margin to near the vanishing point.

Ours is an exciting business.

Forward Sales of Flour Hedged

The big deal for the day is over, but smaller trades continue to pour in. Each is hedged on the market, which hour after hour absorbs these orders in an orderly fashion, instantly responding to the needs of the miller, as it does to the needs of the grain merchant, the exporter, the flour buyer, and the speculator, who helps keep things on an even keel and makes the trades possible.

In looking over the summary of our day's business, I notice that we have sold several distinct and entirely different types of flour; each will be milled to the exacting specifications of the buyer: high protein spring wheat flour, low protein winter wheat flour, clear flour for export, winter wheat baker's flour, flour for a large cake baker, several orders for cookie flour, semolina for the macaroni trade, farina for the cereal manufacturer, and self-rising flour for the Southern housewife. The milling of each of these flours will require different wheat. Our grain buyers are informed about all of these sales and they will know the type of wheat we will need for each separate type of flour.

These sales are hedged in the futures market and our cash wheat buyers will have time to proceed in an orderly manner to buy the kinds of wheat needed as they become available. You can see from these many problems arising for a multiple mill operation how vital we consider the grain exchanges.

So Much for So Little

I like to think of the whole complex procedure of putting a loaf of bread on the consumer's table as being one of the best examples of the miracles of our American business system. Certainly in few other cases can it be demonstrated where an article of so much value can be brought to so many people for so little cost.

Let us follow the steps of putting a loaf of bread on your table. As this meeting is in progress, wheat farmers in the great bread basket of the Southwest are planting their winter wheat, selecting seed that will produce the type of wheat which the miller can convert into the type of flour required by the baker to make a loaf of bread demanded by today's American homemaker. In June and July of 1953, the crop which is now planted will mature. Expensive machinery will move into the wheat fields to harvest the grain which will then move to country elevators. From the elevators the wheat will move to our milling centers by railroad, by truck, and, sometimes, by river barges. In modern sanitary mills our company, and other millers, will convert the wheat into flour. Our customer, the baker, in his modern sanitary plant will produce fresh, fine quality bread which is made available to you, the consumer, at a very low price. In no other food can you acquire such a large measure of value for so few inflated pennies! . . .

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