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ContiBeef™

COMMENT

November 13, 2002

VIA FACSIMILE

Jean A. Webb, Secretary
Commodity Futures Trading Commission

Re: FR Doc. 02-27605 - Chicago Mercantile Exchange Proposed Amendments to the Spot Month Speculative Position Limits for the Live Cattle Futures Contract

Dear Ms. Webb:

The purpose of this letter is to state the views of ContiBeef LLC, a wholly owned subsidiary of ContiGroup Companies, Inc., relative to the proposed amendments that would allow a change in the spot month speculative position limits of the CME Live Cattle futures contract.

ContiGroup Companies, Inc. (formerly Continental Grain Company) has existed as an agribusiness firm for over 189 years. ContiBeef LLC markets over 800,000 cattle annually and is the second largest cattle feeding organization in the United States. We have been clearing members of the Chicago Board of Trade since 1922. We use the futures markets extensively to reduce the commodity price risk associated with the commodities that we produce or trade.

We primarily use the agricultural futures markets as a hedging vehicle, but also use the futures in forward basis contracting of cash commodities; therefore, any position we take relative to proposed changes in these contracts is grounded in the question: *Will this proposed change increase or decrease the hedging effectiveness of the futures or option contracts, and will the proposed change lessen the basis volatility and facilitate convergence of the cash and futures prices?*

As hedgers, we **strongly support** decreasing of the speculative limits in the CME Live Cattle contract from 600 contracts to 300 contracts in the spot month because we feel this change will help reduce basis volatility thereby helping the futures contract to become a more effective hedging instrument for cattle hedgers.

In Attachments 1-5, we compared the behavior of the Live Cattle basis over the last 10 years in 3 different Live Cattle contracts:

- June 1992 to April 1995 (period with 300 contract spec limit)
- June 1995 to April 1998 (period with 300 contract spec limit)
- June 1998 to Oct 2002 (period with 600 contract spec limit)

The June 1995 to April 1998 period saw 18 individual Live Cattle futures contract expirations. The June 1992 to April 1995 expirations are included for comparison, as well as the June 1998 to October 2002 expirations. During this last period (1998 to 2002), the speculative limits had been increased from 300 contracts to 600 contracts.

In each delivery period during the "spot" futures month, we identified the spot cash market as the USDA weighted average steer price in their 5 Area region: Texas/Oklahoma, Kansas, Nebraska, Colorado, and Iowa/Southern Minnesota (http://www.ams.usda.gov/mnreports/lm_ct100.txt). Only the steer price was used, since the delivery specifications call for delivery of steers only. We subtracted this daily cash steer price from the midpoint of the high and low prices for the futures contract. This gave a basis for each day.

For each delivery month, we calculated the monthly average basis, the standard deviation of those daily basis figures, the high basis price, the low basis price, and the range between the high and low basis intra-month. Attachments 1-3 provide the detail information for each of the 3 periods we evaluated at and Attachment 4 summarizes our findings. The average number of deliveries increased 30%. The CME has continuously argued that if the futures and the cash markets get "out of line," market participants will deliver against the contract and force the markets to converge. However, this has not been the case over the last 27 delivery periods.

The number of speculative positions that can be held in the expiring month doubled from 300 to 600 beginning with the June 1998 Live Cattle contract. Over the 27 contract expirations after the change, the number of deliveries made against the futures contract increased 30%. In theory, with many more deliveries to force the futures and cash market together (convergence), this should provide for more efficient markets – markets where the absolute value of the basis is reduced and where the basis should become less volatile.

The reality is that the increased number of deliveries against the Live Cattle futures contract is a direct result of the lack of price convergence, and better convergence just has not happened. Since the June 1998 futures delivery period:

- The absolute value of the basis, which provides a measure of movement from par, has actually moved 18% further from par (cash = futures); thus, the basis has become wider and less predictable.
- The intra-delivery month volatility of the daily basis, as measured by the daily standard deviation, increased 45%
- The difference between highest intra-month basis and the lowest intra-month basis during each of the 27 delivery periods increased by an average of 49% compared to this same intra-month range under the 1995-98 contract

These statistics illustrate that the basis within the delivery month has become more volatile. But it gets worse when you look at the overall picture. Attachment 5 shows two different graphs of

the average monthly basis for each of the June 1995 to April 1998 contracts and the June 1998 to October 2002 contracts.

All but two of the 1995-1998 contracts' average basis numbers fell within the narrow range of \$ -.75/cwt to \$ -1.75/cwt for an overall high/low range of \$1.00/cwt. The 1998-2002 contracts tell a different story entirely. The monthly average basis figures had a high of \$ +1.50/cwt to a low of \$ -3.00/cwt for an overall high/low range of \$ 4.50/cwt. The graphs illustrate the increased variability in the monthly basis averages.

This increased basis variability has made the Live Cattle futures contract a much less effective hedging vehicle. ContiBeef LLC uses the futures markets to hedge to reduce our cash price risk. Unfortunately, the June 1998 contract changes have actually increased the price risk in running our business – we now must deal with a tremendous basis risk in addition to the cash price risk.


We feel certain that if things remain the same with the futures contract (speculator limit of 600 contracts, current contract delivery specifications, and lack of deliverable supply), that abnormal basis distortions, large deliveries against the contract, and poor futures/cash price convergence will continue into the future. The last 27 delivery periods have shown that allowing more deliveries has NOT made the Live Cattle contract a more hedger-friendly contract. In fact, it created a less useful hedging instrument where the basis has become less consistent and less predictable.

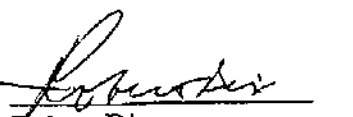
In addition to basis volatility, we whole-heartedly agree with the Chicago Mercantile Exchange when they state in the application now before the Commission, "the proposed level is 'more in balance with deliverable supplies' for the Live Cattle futures contract." As weights of cattle have increased, the number of cattle in a deliverable position continues to decline, which allows for possible squeezes in the delivery month.

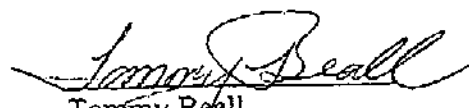
Finally, ContiBeef LLC is concerned about the Chicago Mercantile Exchanges' changing contract specifications for contracts that have already been listed. Our preference would be that any proposed contract changes take effect on newly listed contracts, rather than currently traded contracts in which there is open interest.

Again, we **strongly support** decreasing of the speculative limits in the CME Live Cattle contract from 600 contracts to 300 contracts in the spot month because we feel this change will tend to reduce basis volatility thereby helping the futures contract to become a more effective hedging instrument for cattle hedgers. We appreciate the opportunity to share our views with the Commission and are willing to answer any questions you may have relative to the position of ContiBeef LLC.

Sincerely,


John Rakestraw
Chief Executive Officer


Robert Dix
Option Programs Manager


Tommy Beall
Marketing Manager

June 1992 to April 1995 Live Cattle Delivery Periods
(18 Delivery Periods BEFORE the June 1995 Contract Change)

	Trading Days in the Delivery Period	Number of Futures Deliveries	Average Basis in Delivery Period	Basis Standard Deviation in the Delivery Period	High Basis in Delivery Period	Low Basis in Delivery Period	Range of Basis in Delivery Period
Jun 1992	12	18	0.659	0.351	1.055	-0.013	1.068
Aug 1992	11	4	-0.099	0.144	0.105	-0.360	0.465
Oct 1992	15	37	-0.244	0.277	0.275	-0.725	1.000
Dec 1992	12	14	-0.115	0.553	1.193	-0.928	2.120
Feb 1993	9	13	-0.823	0.364	-0.343	-1.498	1.155
Apr 1993	14	28	0.135	0.260	0.603	-0.473	1.075
Jun 1993	13	0	0.647	0.405	1.165	-0.153	1.318
Aug 1993	12	0	-0.251	0.268	0.178	-0.698	0.875
Oct 1993	15	0	-1.208	0.527	-0.120	-2.283	2.163
Dec 1993	12	64	-0.760	0.525	0.113	-2.098	2.210
Feb 1994	10	10	-0.998	0.300	-0.600	-1.513	0.913
Apr 1994	15	13	-0.708	0.238	-0.280	-1.053	0.773
Jun 1994	14	72	-0.291	0.640	1.005	-1.138	2.143
Aug 1994	13	361	-1.841	0.654	-0.753	-3.163	2.410
Oct 1994	11	415	-1.923	0.754	0.190	-2.670	2.860
Dec 1994	14	31	-0.599	0.318	-0.130	-1.340	1.210
Feb 1995	11	55	-1.387	0.618	-0.613	-2.878	2.265
Apr 1995	9	20	-0.744	0.352	0.060	-1.083	1.143
AVERAGE	12.3	64	-0.586	0.419	0.172	-1.337	1.509

*** Basis calculation: national cash steer price minus CME Live Cattle futures price

Cash price used: USDA daily weighted average 5 Area steer price (USDA report LM_CT100.TXT)

Futures price used: average of the high and low futures price for the day.

ATTACHMENT 1

June 1995 to Apr 1998 Live Cattle Delivery Periods
(18 Delivery Periods OF the June 1995 Contract Change).

	Trading Days in the Delivery Period	Number of Futures Deliveries	Average Basis in Delivery Period	Basis Standard Deviation in the Delivery Period	High Basis in Delivery Period	Low Basis in Delivery Period	Range of Basis in Delivery Period
Jun 1995	15	95	0.494	0.632	1.415	-0.949	2.358
Aug 1995	14	630	-0.257	0.547	0.678	-1.735	2.413
Oct 1995	12	254	-1.086	0.383	-0.175	-1.500	1.325
Dec 1995	14	495	-1.159	0.332	-0.633	-1.605	0.973
Feb 1996	13	151	-1.196	0.489	-0.340	-2.153	1.812
Apr 1996	12	238	-0.845	0.420	-0.233	-1.445	1.213
Jun 1996	10	212	-1.319	0.564	-0.653	-2.813	2.160
Aug 1996	15	691	-1.861	0.322	-1.398	-2.315	0.918
Oct 1996	14	92	-1.330	0.796	-0.405	-2.910	2.505
Dec 1996	10	4	-1.065	0.977	0.780	-1.938	2.718
Feb 1997	9	60	-1.115	0.553	-0.458	-2.215	1.758
Apr 1997	13	154	-1.347	0.496	-0.605	-2.603	1.998
Jun 1997	11	101	-1.008	0.397	-0.235	-1.690	1.455
Aug 1997	15	1054	-1.138	0.687	0.100	-2.250	2.350
Oct 1997	15	271	-1.637	0.420	-0.935	-2.365	1.430
Dec 1997	12	104	-1.296	0.663	-0.203	-2.245	2.043
Feb 1998	9	309	-1.783	0.692	-0.635	-2.760	2.125
Apr 1998	13	450	-1.852	0.778	-0.883	-3.993	3.110
AVERAGE	12.6	298	-1.156	0.564	-0.268	-2.193	1.926

*** Basis calculation: national cash steer price minus CME Live Cattle futures price

Cash price used: USDA daily weighted average 5 Area steer price (USDA report LM_CT100.TXT)

Futures price used: average of the high and low futures price for the day.

ATTACHMENT 2

June 1998 to October 2002 Live Cattle Delivery Periods
(27 Delivery Periods OF the June 1998 Contract Change)

	Trading			Basis				
	Days	Number	Average	Standard	High	Low	Range of	
	In the	of	Basis in	Deviation	Basis in	Basis in	Basis in	
	Delivery	Futures	Delivery	in the	Delivery	Delivery	Delivery	
	Period	Deliveries	Period	Delivery	Period	Period	Period	
Jun 1998	17	849	-0.817	0.409	-0.023	-1.500	1.478	
Aug 1998	16	597	-0.871	0.492	-0.245	-2.175	1.930	
Oct 1998	20	1500	-2.015	0.554	-0.975	-3.115	2.140	
Dec 1998	18	180	-1.014	0.619	0.225	-2.410	2.635	
Feb 1999	14	1030	-2.371	0.923	-1.263	-4.500	3.238	
Apr 1999	20	1020	-1.728	0.759	-0.703	-3.325	2.623	
Jun 1999	18	21	-0.105	0.473	0.573	-0.960	1.533	
Aug 1999	17	34	-0.874	0.621	0.063	-2.050	2.113	
Oct 1999	20	175	-1.738	0.789	-0.418	-3.175	2.758	
Dec 1999	18	11	-0.559	0.698	0.928	-1.783	2.710	
Feb 2000	16	204	-1.596	0.429	-0.678	-2.268	1.590	
Apr 2000	14	102	-0.138	0.440	0.625	-1.000	1.625	
Jun 2000	20	10	1.146	0.799	2.313	-0.800	3.113	
Aug 2000	19	898	-1.472	0.534	-0.490	-2.463	1.973	
Oct 2000	17	373	-2.458	0.894	-1.155	-3.965	2.810	
Dec 2000	19	112	-2.231	1.097	-0.068	-4.875	4.808	
Feb 2001	17	201	-2.401	0.936	-1.000	-4.440	3.440	
Apr 2001	15	83	0.850	1.109	1.960	-1.858	3.818	
Jun 2001	20	112	1.199	1.238	2.650	-0.930	3.580	
Aug 2001	20	458	-1.535	0.598	-0.528	-2.738	2.210	
Oct 2001	18	239	-0.407	0.987	1.278	-2.060	3.338	
Dec 2001	15	125	-1.989	1.705	0.283	-4.733	5.015	
Feb 2002	18	790	-1.861	1.190	0.223	-3.858	4.080	
Apr 2002	17	106	1.519	1.553	3.428	-2.025	5.453	
Jun 2002	15	2	0.654	0.576	2.025	-0.083	2.108	
Aug 2002	20	624	-1.907	0.831	-0.405	-3.568	3.163	
Oct 2002	19	648	-3.153	0.754	-2.155	-4.535	2.380	
AVERAGES	17.7	389	-1.032	0.815	0.240	-2.637	2.876	

*** Basis calculation: national cash steer price minus CME Live Cattle futures price

Cash price used: USDA daily weighted average 5 Area steer price (USDA report LM_CT100.TXT)

Futures price used: average of the high and low futures price for the day.

3 Time Period Comparison of Averages

<i>Delivery Contract Periods</i>	<i>Trading Days in the Delivery Period</i>	<i>Number of Futures Deliveries</i>	<i>Average Basis in Delivery Period</i>	<i>Basis Standard Deviation in the Delivery Period</i>	<i>High Basis in Delivery Period</i>	<i>Low Basis in Delivery Period</i>	<i>Range of Basis in Delivery Period</i>
<i>Jun 1992 to Apr 1995</i>	12.3	64	-0.586	0.419	0.172	-1.337	1.509
<i>Jun 1995 to Apr 1998</i>	12.6	298	-1.156	0.564	-0.268	-2.193	1.926
<i>Jun 1998 to Oct 2002</i>	17.7	389	-1.032	0.815	0.240	-2.637	2.876

Have We Been Better Off Since the June 1998 Contract Change?

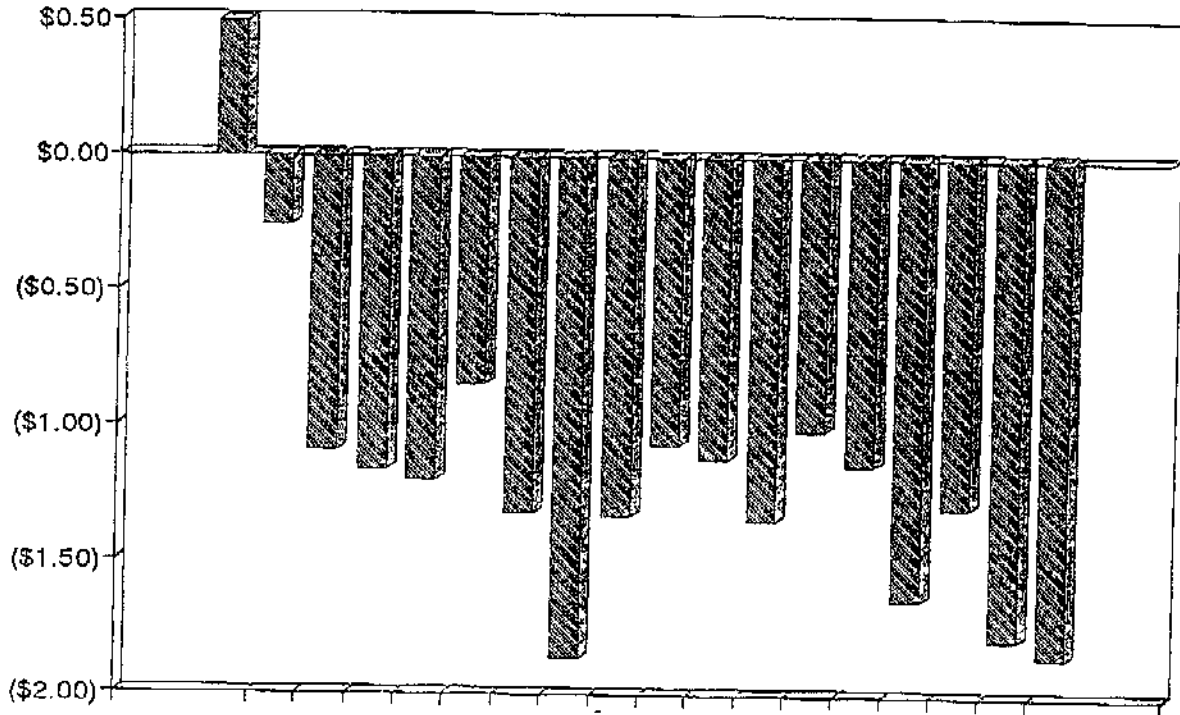
DELIVERIES have gone up 30%

The VARIABILITY of the daily basis has increased 45%

The average BASIS RANGE (high basis minus low basis) during that month has increased 49%

ATTACHMENT 4

Delivery Month Basis June 1995 to April 1998 Contracts



Delivery Month Basis June 1998 to October 2002 Contracts

