**STRUCTURAL BUILDING COMPONENTS MAGAZINE**
December 2001

# Forward Pricing…Your Options! by Matt Layman

As a consumer of lumber, you have several options to protect your future. Here are your possibilities.

1) Ask a producer to cover you at a firm price for the extended time that you need. (Let's get the impossible option out of the way first.)
2) Ask your banker to give you a line of credit that will cover your needs, buy the lumber and put it in storage in your yard or warehouse. (Not a bad option, but it's not your purpose for being in business.)
3) Borrow the money, buy the lumber and enlist the services of a reload or warehouse. (My favorite!)
4) Give the entire order to a wholesaler and trust him/her to cover it when you need it or work it out using the options above. (But think! You made a commitment and placed your potential outcome in the hands of a third party who may or may not be capable of pulling off the deal. If the first three options were not good for you, why would they be good for a wholesaler, unless of course s/he is a legitimate reload.)
5) Enlist the services of a commodities broker who can execute a lumber futures hedge for you. Make sure you understand and can handle the volatility of the market. If you think the cash market is wild, the futures market can be fatal. It's not a move to make on faith. However, this is a viable option if you are aware of the relationships between your product, Southern Yellow Pine for example, and the futures contract of SPF. It isn't apples to apples, but it is doable and relatively simple. For every 100,000 feet of lumber you have presold and unpurchased, you can buy one futures contract as a hedge. If the market goes higher while you are waiting to buy, you should have a profit in your futures contract that will somewhat offset the higher price you pay for your cash product. If the market drops, you'll lose on the futures contract, but you'll make extra on the cash. This is very simple in theory, but a bit more difficult in execution.
6) Lumber “swaps” are the newest idea on the block. This is a method by which you can buy your lumber or panel needs as much as three years in advance, at a fixed price. The supplier uses a formula or relationship between your product and the futures markets or money markets, taking into consideration the futures contracts nearest the time frame you need. Settlements are made either in physical product or financially to offset gains or losses, depending whether you are buying or selling.

My only word of caution is to be leery of hedging an SPF futures contract against other species. It's not apples to apples. To find willing forward pricers, I recommend searching the Web. That's where the serious players can be found. For example, search for “lumber swap,” “lumber forward pricing,” “lumber futures,” etc. Finally, my Estimated Decision Points (EDP) are very helpful. Happy Trading!

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