What is Convergence?

- As a futures contract approaches expiration, normal economic forces will cause cash and futures prices to come together—that is, the basis will ***approach*** zero—at the par points, for the par quality of the commodity.

- Convergence is essential for price discovery and risk management, allowing market participants to effectively hedge their cash exposures with futures.

- Convergence is core to the DMO Missions of preventing/detecting manipulations and contract performance.

Spread Relationship to Convergence

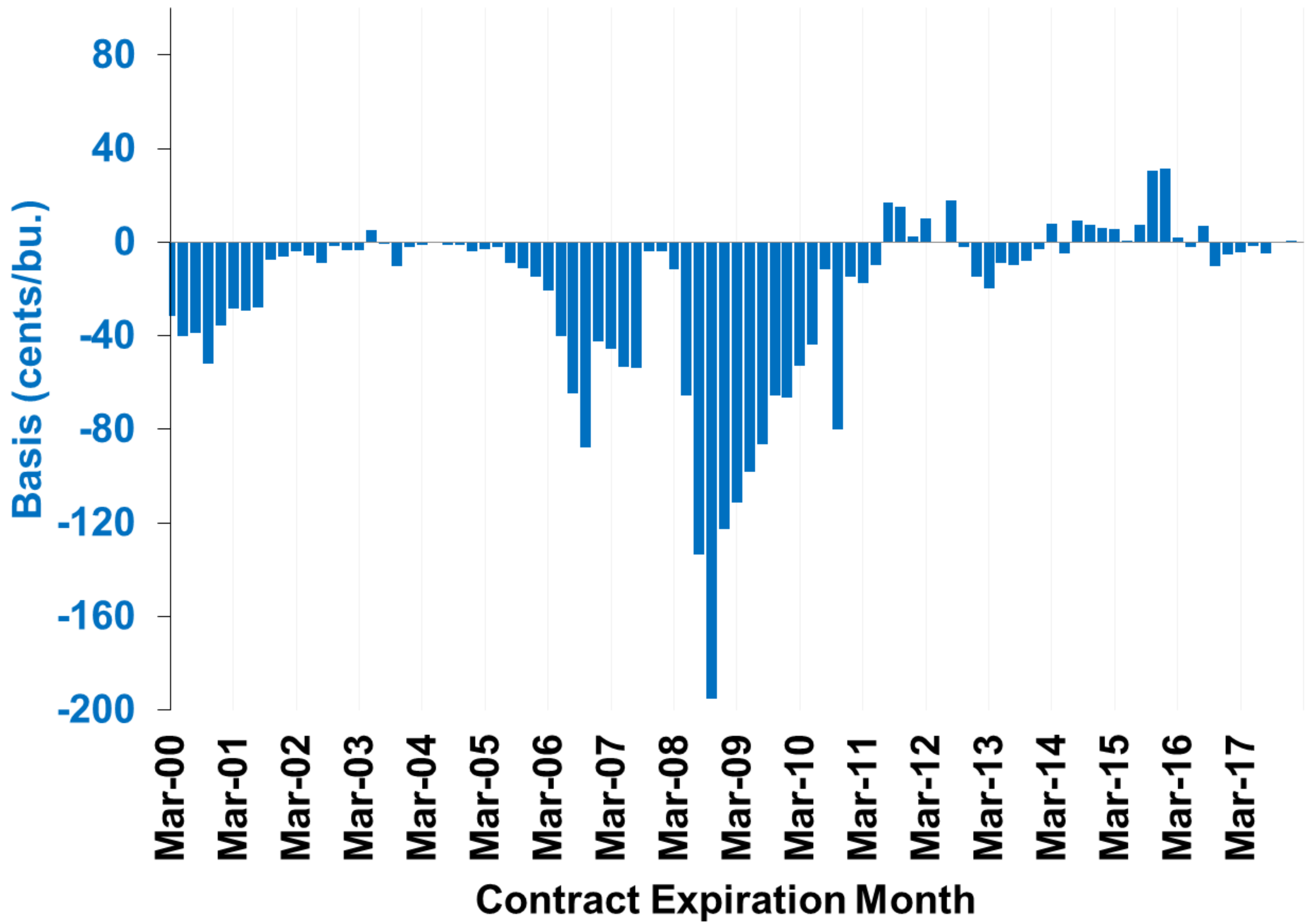
- Those taking delivery of a shipping certificate have the option to hold and pay storage, redeliver, sell, or cancel the certificate for load out of physical grain.

- When future spreads approach full carry, investors buy lower nearby futures, sell higher deferred futures, take delivery of certificates, pay storage, and redeliver to earn a risk-free return on investment without handling grain.
  - These financial investors have no interest in owning physical grain, no matter how cheap it is relative to futures.
  - Commercials deliver certificates but grain isn’t loaded out, so cash and futures decouple.

Problems from Poor Convergence

- Price discovery is weakened.
- Hedging effectiveness is reduced.
- Crop insurance revenue estimations can be inflated, lowering indemnities.
- Agriculture lending is reduced, i.e., "credit crunch."
- Forward contracting is potentially less available.
- Contract can become susceptible to manipulation.

CBOT (SRW) Wheat Toledo Basis



CBOT (SRW) Wheat Basis Predictability