­ Price Relations Among Hog, Corn, and Soybean Meal Futures by Qingfeng “Wilson” Liu.

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Carrying costs of commodities have a higher carrying cost and being able to short the underlying asset can prove to be difficult. The Author states that strategies such as cash and carry cannot be executed where excess supply in the short term which cause a drop in nearby spot prices.

Lui talks about mean reversion in his paper, which gives an environment for possible arbitrage. He specifically looks at the co-integration of hog, corn, and soybean meal to try and look for over/under reactions in the market.

Taking advantage of these discrepancies shows that the commodities markets we are dealing in are not efficient. The market should have accounted for them in their trading activities. Lui finds that the three prices of the commodities are co-integrated and runs simulations to test and see if one could take advantage of price movements with mean reversion. The tests he runs on his findings are series tests, staionarity tests, multivariate co-integration tests, and error correction models.

His findings show a positive return when implementing his model. His models use 3 trigger points that are different standard deviations from the mean. He would offset his position that he entered into with the opposite type of trade. In the end there was too much uncertainty with his data to know if this could be put to practical use.