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FOCUS ON FUTURES

Friedberg Mercantile Group Ltd.



Volume 19, No. 4 May 24, 2016

## Cocoa: Smaller West African crops, but demand is soggy

Over the past month cocoa prices have responded to poor West African weather with a \$400-per-tonne rally (Chart 1). Output estimates for 2015-16 for the three largest producing nations in the region have been falling.

With the mid-crop harvest in full swing in the Ivory Coast, forecasts for the total crop have dropped to 1.6 million tonnes, down about 11% from record output of 1.8 million tonnes in 2014-15. The pattern of weekly port-arrival data supports these estimates. In early April arrivals were running 3.5% behind the same time last season. Now we're lagging by about 7%. With weekly volumes running at about 75% of last year's pace, the forecast for output of only 1.6 million tonnes looks reliable.

In addition, bean quality has been poor. The acceptable exportable standard is 100 beans per 100 grammes, but many beans have been averaging around 120 beans per 100 grammes. There are reports that say that as many as 50,000 tonnes have been declined by European trade houses.

There is no information available out of Ghana and Nigeria similar to the arrival figures we see out of the Ivory Coast. Sporadic news reports give the impression that output in those countries is set to fall by about the same amount for the current marketing year.

The bleak outlook, however, can turn around quickly. All these estimates are based on very dry conditions experienced from December through March. As of late April, rains were returning to key growing regions. The mid-crop in the Ivory Coast runs all the way through September, so there is ample time for some catch up.

On the demand side, growth in the regions that reported first-quarter grindings remains anemic with one exception. Southeast Asian grinding countries – which includes Indonesia, Malaysia, and Singapore – were 2.9% higher year-over-year. But it was downhill from there. The European grind was down 0.2%, and North America was 2.2% lower. Analysts had expected better results for both.

We are not optimistic for the prospects of improvement in processing activity. With the recent rally in beans

and stagnant product prices, there is little incentive for processors to grind more than is needed to meet immediate commitments. Butter prices have been steady, but powder prices have drifted lower in recent months. Chart 2 shows the combined butter/powder ratio near multi-year lows.

One theory has it that the weak grind numbers in Europe and North America (the traditional grinding regions) is a result of a shift in grinding activity to countries in West Africa and Asia. Asian numbers are published quarterly, and as illustrated above, the first quarter of 2016 represented solid growth. But for all of 2015 the grind was down 2.8%.

Grinding activity for West Africa is not very transparent. We do know that capacity has been increasing, but according to a February report published by the International Cocoa Organization (ICCO), actual grinding for the 2015-16 marketing year rose less than 1%.

The ICCO forecast global ending stocks at 35.4% of consumption. That may sound high when compared with other commodities, but for the cocoa market it is at the low end of the 10-year range. Considering that more than 70% of global supplies grow in the same part of the world and are subject to similar weather conditions, inventory levels are deemed to be vulnerable.

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We were stopped out of our short position at \$3,200-per-tonne, basis the near month. Given the lethargic rate of demand growth, though, we continue to view cocoa as an overpriced commodity in the long-term. A strong tail end

to West African mid-crops should quash the rally. We remain sidelined, but we will watch weekly Ivorian arrivals with interest.

[Sholom Sanik, May 10, 2016]

Chart 1 – July cocoa



Courtesy Reuters

Chart 2 – Cocoa butter/powder ratio



## SOYBEANS

### Enter the bull

For most of the past nine months, traders have focused primarily on the record soybean crops being grown by the world's three largest producing countries, the US, Brazil, and Argentina. Spot prices crawled along in a narrow range, between \$8.50 and \$9.50 per bushel (Chart 3).

In mid-April the seemingly infallible South American crops began to experience weather problems – not enough rain in Brazil and too much in Argentina. Crop estimates started dropping. As the May USDA supply/demand report approached, it was widely anticipated that the USDA

would be trimming Brazilian and Argentinean crop-size estimates. The USDA gave the bulls what they were looking for, and the market's response was a near limit-up rally, the biggest in as long as anyone can remember.

The most bullish revisions to the old-crop marketing year, however, were not necessarily the lower South American output figures. Those estimates were very close to the street guesstimates. Rather, if there was a surprise, it was on the demand side.

Argentinean production was slashed from 59 million

tonnes, to 56.5 million tonnes. Actually, the average guesstimate was 55.73 million tonnes, so the figure was a bit *higher* than expected. Brazilian output was lowered by just 1 million tonnes from the April estimate, to 99 million tonnes, a bit lower than the average guesstimate. With South American revisions in line with expectations, the report served merely as confirmation of the weather damage.

The revision to the demand side was not expected. The USDA raised 2015-16 global consumption by 2 million tonnes. Part of the revision was an increase in the estimate for US exports, which were expected to flounder after South American supplies became available.

As a result of all these changes from the April report, the estimate for global ending stocks fell by close to 5 million tonnes. Stocks as a percentage of consumption will fall to 23.3% from the April estimate of 24.8%. In itself, that would not have been too devastating. At 23.3%, the market could still be considered well supplied. The average carry-out between 2011 and 2014 was 21% of usage.

Perhaps the real trigger was the outlook for the new marketing year. Based on early USDA planting intentions, the 2016-17 US crop is expected to fall by about 4 million tonnes. For South America, the estimates are slightly higher than for the 2015-16 crops that are now being harvested. However, those crops are not planted until late this year.

The eye opener was the estimate for 2016-17 demand. The USDA is forecasting a 10-million-tonne jump in consumption. The revisions to the 2015-16 balance sheet turned the old-crop marketing year from a 4-million-tonne global production/consumption surplus to a 2-million-

tonne deficit. The forecasts for 2016-17 call for a 4-million-tonne deficit. So for the second consecutive season, we will be drawing down inventories. Stocks as a percentage of consumption will fall to 20.7% of usage – the lowest level since 2011-12.

Chinese soybean demand cannot be compared with its demand for other commodities. China grows less than 15% of its soybean needs. With corn and wheat, the Chinese are largely self sufficient. Government initiatives to eat into the country's enormous stockpiles of commodities cannot apply to soybeans to any meaningful degree because ending stocks are equal to only about 15% of usage. That compares with anywhere from 50% to 100% for corn, wheat, and cotton. The USDA estimates that total imports from all countries will grow to 87 million tonnes in 2016-17 from 83 million tonnes in 2015-16, and from 78 million tonnes in 2014-15.

Another factor that could complicate matters is that we've been seeing forecasts for a hot and dry summer for the US. It's definitely premature to speculate on this. However, the late-season crop losses in South America and surprisingly strong demand have shifted the fundamentals. We've moved from an oversupplied market to the possibility that 2016-17 global ending stocks will be dipping to the low end of the 10-year range. A crop accident in the US could spell the end of the bear market.

Establish long positions in November soybeans, currently trading at around \$10.50 per bushel. Place initial stops at \$9.90, close only.

*[By Sholom Sanik, May 13, 2016]*

Chart 3 – Soybeans nearest contract



*Courtesy Reuters*

**CORN****New crops must facilitate growing demand**

Late-season weather problems in South America have lowered 2015-16 crop estimates for both Brazil and Argentina. The May USDA supply/demand report lowered Brazilian production by 3 million tonnes, to 81 million tonnes, and Argentinean output by 1 million tonnes, to 27 million tonnes. The estimates were in line with analyst guesstimates, though, so the downward revisions were no great surprise.

The market responded with a tepid rally, which kept prices inside the pre-report range. The uptick was probably more related to the sharp rally in the soybean market, which was responding to its own bullish news (*Focus on Futures*, May 13). In the days following the release of the report, however, corn prices continued to move higher and are now challenging the April highs that took July corn past the \$4-per-bushel level.

Revisions to the US balance sheet were on the bullish side. Export estimates have been below last year's all season long, but have been playing catch up. The USDA revised its forecast for the 2015-16 marketing year, which runs through the end of August, to 43.8 million tonnes, up 1.9 million tonnes from its April estimate. At this time of year, even during seasons in which exports are large, weekly sales begin to fade as foreign buyers start to book supplies from South American origins. But exports have been unusually strong over the past couple of months. Consider: Over the past 10 weeks, export commitments averaged 1.13 million tonnes, compared with only 589,000 tonnes in the comparable period in 2014-15.

As a result of the revisions to the South American and US balance sheets, the estimate for global ending stocks fell, but only slightly.

Turning to the USDA's first comprehensive look at the upcoming 2016-17 marketing year, however, the market takes on a more bullish tone. The primary feature was the forecast for a huge jump in global consumption to 1.011 billion tonnes, up 43 million tonnes from 2015-16. Global ending stocks would fall to 20.4% of usage, down from 21.4% the previous season.

In itself this forecast is not extraordinary because the early output estimate is about the same as the consumption figure, so there would be no drawdown of global inventories. What makes it interesting, however, is that the production forecast relies on several assumptions.

US farmers are planting the most acres this spring since 2013-14, and the planting pace is well ahead of the five-year average. The USDA is forecasting a record crop of 366 million tonnes (14.43 billion bushels). Growing conditions would have to be perfect, though. The USDA estimates yields at 168 bushels per acre, slightly below last year, but still the third highest on record. The problem is that one of the typical post-El Niño effects is drought. The prevailing view among meteorologists seems to be that we are in for a hot summer. The optimum planting conditions should provide a buffer, but it may be a bit premature to be predicting optimum growing conditions.

Furthermore, the output forecast also includes estimates for a record-by-far 34-million-tonne crop in Argentina. The largest Argentinean crop to date reached 28.7 million tonnes in 2014-15. We're assuming that this optimistic estimate is based on the more favorable financial environment available to Argentinean farmers.

In December the newly elected government eliminated export taxes and devalued the peso, which should provide an incentive to plant more corn. Nevertheless, the USDA estimate for a close to 20% increase in output appears to us as quite the stretch, after we've observed just how volatile the weather can be and how quickly crops that were all but "in the bag" (particularly in Brazil) can suffer significant losses.

In conclusion, the 2016-17 global ending stocks estimate, as illustrated above, has already dipped to its lowest level since 2013-14. Failure to meet any of the exuberant output targets could draw stocks down to the levels that sent corn prices flying to \$8 per bushel.

Buy December corn, currently trading at about \$4.05 per bushel. Place initial stops at \$3.60, close only.

*[By Sholom Sanik, May 18, 2016]*

Chart 4 – December corn



Courtesy Reuters

## SUGAR

### The bull charges

Earlier in the 2015-16 marketing year, the Indian government enacted legislation that required mills to export surplus sugar. We never believed that it was a great idea, because we felt it would jeopardize the longstanding government policy of maintaining ample inventories of the cheap carbohydrate.

With growing consumption, an El Niño-compromised 2015-16 crop, and the strong potential for drought carrying into the 2016-17 season, selling sugar abroad was risky. In the February 24 issue of *Focus on Futures* we wrote: "...we are quite certain that – sooner or later – legislative action will reverse the accommodative export rules. Any exports India contributed to the pool that helped balance the looming global deficit can no longer be counted on." And sure enough, the program has been canceled.

The government had been offering exporters a subsidy equal to 2% of the price of every tonne that was exported. Exporting without the subsidy is not profitable, so Indian sugar exports are expected to grind to a halt for the foreseeable future.

Most estimates put 2015-16 output at 25 million tonnes, down from early-season forecasts that reached as high as 29 million tonnes. And we're seeing estimates for 2016-17 as low as 23.5 million tonnes.

Consumption has grown materially in India over the

past few years. The estimates range from between 25.5 million tonnes to over 27 million tonnes, but all agree that demand will be higher than consumption – slightly for 2015-16, but then by 3 to 4 million tonnes in 2016-17. There go your inventories!

If this loose model is anywhere near accurate, Indian ending stocks will drop from over 10 million tonnes in 2014-15 to perhaps 6 million tonnes, their lowest level since the consecutive drought years of 2009 and 2010. It may be a little premature, but some analysts are predicting that India will be a net *importer* of sugar by 2016-17.

The Brazilian 2016-17 marketing year has begun, and estimates vary widely, but all analysts are forecasting that sugar output will rise between 3 and 4 million tonnes above 2015-16. Keeping in mind that the crushing season has just begun, any estimates are assuming a very generous jump in the amount of cane that will be used for sugar over ethanol.

The actual cane crop was only a bit higher than in 2015-16, but the forecasts for sugar output are estimated to be up 10%. There is no evidence this early in the season, but we're wondering if the \$20-per-barrel jump in crude oil prices will not stimulate ethanol demand and tilt the ratio in ethanol's favor.

EU production is also slated for recovery, so the losses in India are mitigated by higher production in Brazil and

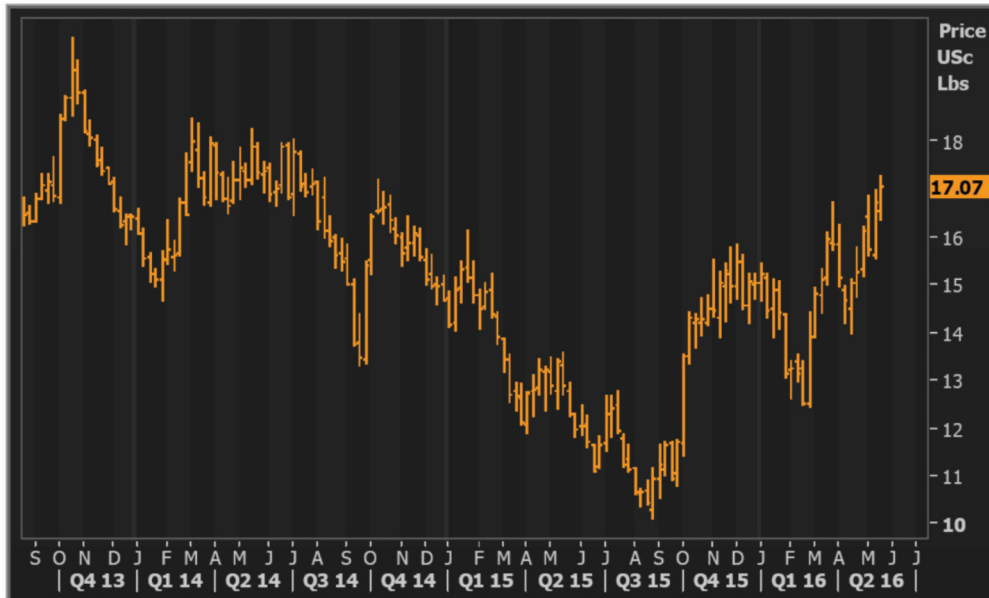
the EU. Nevertheless, global consumption estimates are on the rise, and analysts are steadfast with their global production/consumption forecasts. We are now seeing estimates for the 2015-16 deficit as high as 9 million tonnes, with a slight improvement for 2016-17 at between 7 and 8 million tonnes.

Chinese sugar market issues do not grab many headlines, mainly because the Chinese were largely self-sufficient until a few years ago, and imports were targeted for

inventory building. Now for the second consecutive season, output has fallen to about 8 million tonnes, down from the average of the three previous years of 13 million tonnes. During the same period, usage has grown from about 15 million tonnes to close to 18 million tonnes. Exports are estimated to leap from about 4 million tonnes to 8 million tonnes.

The market has traded up to a two-year high. Remain long call options. *[By Sholom Sanik, May 20, 2016]*

Chart 5 – Sugar weekly nearest contract



Courtesy Reuters

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