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Corn: Argentinean woes and strong demand

The soybean market has been attracting most of the attention related to the Argentinean drought, but the corn crop has been battered and bruised as well. In response, July corn has rallied close to 40¢ per bushel since mid-January (Chart 1).

Argentina's government eliminated the corn export tax in time for the planting of the 2016-17 crop. Output jumped by about 35%, to over 40 million tonnes, and established Argentina as the world's third-largest exporter behind the US and Brazil. Early-season forecasts based on planted area were looking for a record crop of 42 million tonnes. But the weather has wreaked havoc with the crop.

The March USDA crop report revised its estimate down by 3 million tonnes, to 36 million tonnes. Private forecasters are as low as 33.5 million tonnes.

Brazilian output was revised down slightly, by 500,000 tonnes, to 94.5 million tonnes, down from last year's record output of 98.50 million tonnes. For soybeans, Brazilian output is going to compensate for at least part of the Argentinean losses. As illustrated, not so for corn.

Cumulative bullish revisions to the US balance sheet contained in the March crop report tightened the 2017-18 global balance sheet even further. There were material revisions in two of the three major demand categories. Ethanol usage continues to grow. The estimate was revised up by 1.27 million tonnes (50 million bushels), to a record 141.6 million tonnes.

As recently as early February, US export commitments for the 2017-18 marketing year were running 20% behind a year earlier. A recent surge in foreign sales narrowed that gap to only 7%. The USDA therefore revised its estimate for annual sales upward by 4.45 million tonnes (175 million bushels), to 56.52 million tonnes. Not that it was much of a surprise, but it was an extraordinary revision nonetheless.

The global balance sheet for corn was tight even before the Argentinean weather crisis. Recent develop-

ments have tightened the market further.

With shrinking supplies and strong demand, ending stocks were revised downward by 4 million tonnes, to 18.5% of consumption, down from the February estimate of 19%. That compares with 22% and 21.8% in 2015-16 and 2016-17, respectively, and would put ending stocks back to where they were in 2013-14, before the explosive production growth we saw in the US, Brazil, and Argentina.

Looking ahead, we're close to the 2018-19 US planting season. In 2017-18, soybeans "stole" acres from corn. Soybean area jumped to 90.1 million acres from 83.4 million acres, while corn area dropped to 90.2 million acres from 94 million acres.

Early indications from the USDA are that corn acres will be about equal to 2017-18. But new-crop soybean prices have been stronger than corn prices during the critical period when planting decisions are made (Chart 2), which opens the possibility of a further shift to soybeans. Corn prices would have to increase substantially to spark increased acreage.

The bullish case is well rounded. Remain long as per our original October 4 recommendation. Raise stops to \$3.75 per bushel, basis July, close only.

[By Sholom Sanik, March 14, 2018]

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Chart 1 – July corn

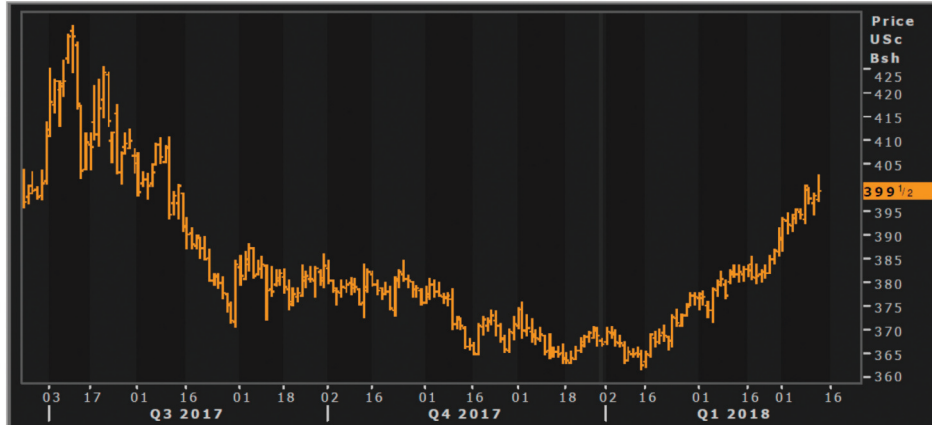


Chart courtesy Reuters

Chart 2 – November soybeans/December corn ratio



Chart courtesy Reuters

SOYBEANS

Argentina is yesterday's news

Drought has ravaged the 2017-18 soybean crop in Argentina. Since mid-January, prices have rallied by more than \$1 per bushel, or roughly 12%, to close to \$11 per bushel (Chart 3). During this period, commodity funds swung from a massive net-short to an even larger net-long position, almost as large as the position they held when soybeans reached \$18 per bushel in 2012 (Chart 4). Is the exuberance warranted?

Traders were expecting the USDA to slash the Argentinean estimate sharply, so it was no great shock when the actual figure came in at 47 million tonnes, below the average guesstimate of 48.3 million tonnes. That was down

from the 54-million-tonne February estimate. Before the hot and dry weather hit, the USDA forecast for the Argentinean crop was 57 million tonnes, about the same as the average of the previous two seasons at 57.3 million tonnes.

Some estimates put the crop as low as 40 million tonnes! Indeed, thus far, the weather has not been this negative for crops as far back as anyone can remember. By the same token, history has shown that analysts get a bit carried away and paint a very worst-case scenario. In fact, since all these bleak estimates have been issued, many significant regions have received a very decent amount of precipitation. So quite possibly, the next round of responsible estimates could be a

bit higher. While there no doubt has been enough irrevocable damage, our sense is that whatever effect the Argentinean situation will have on the market is “in the market.”

Of note, Brazil sailed through the season without any weather problems, leading the USDA to once again increase its estimate for 2017-18 output, by 1 million tonnes, to 113 million tonnes. That is up from early-season estimates of 108 million tonnes. So a little help from Brazil cushions the blow.

The theory that motivated traders to drive prices higher in anticipation of even higher prices was that Asian importers would shift purchases *en masse* to the US. Hasn't happened – certainly not the way it has for corn (see *Focus on Futures*, March 14). In early February, US export commitments were running 13% behind a year earlier. The “shift” has been paltry. We are still running 8% behind last year. The pace has been sufficiently lethargic for the USDA to have actually *lowered* its estimate for annual sales in the March crop report by 1 million tonnes, to 56 million tonnes. While the USDA lowered the estimate for Argentinean exports for 2017-18 by

1.7 million tonnes, it also increased Brazilian exports by 1.5 million tonnes.

With most – or perhaps even all – of the Argentinean losses accounted for in the balance sheet, global ending stocks are estimated at 27.5% of consumption. That's down from 28.5% in February and compares with 29.3% in 2016-17. So no doubt Argentina has had an impact.

However, as we have pointed out in previous articles on this topic, the soybean market has entered a new paradigm in terms of global inventories. In the previous 10 years, ending stocks averaged just below 24% of consumption. So we're still well above what has been the norm.

We believe that once market participants absorb the reality that there will not be any global supply crisis caused by the Argentinean drought, prices will revert and trade back to the recent lows and beyond. Remain long November \$10-per-bushel puts, as per our February 23 recommendation.

[By Sholom Sanik, March 21, 2018]

Chart 3 – November soybeans



Chart courtesy Reuters

Chart 4 – CFTC commodity fund net-long position (bar), CBOT soybeans open interest (line)

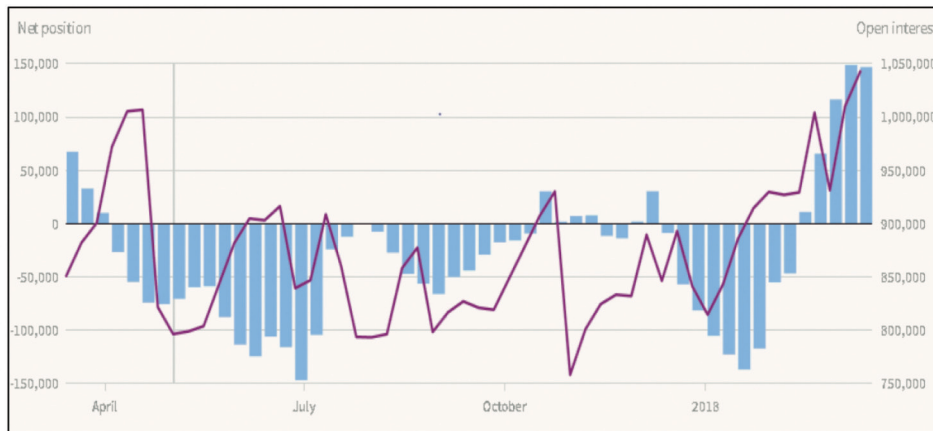


Chart courtesy Reuters

COTTON

Are strong US exports just a mirage?

The March USDA crop report for cotton was largely indistinguishable from the February report. With few changes to production and consumption estimates, 2017-18 global ending stocks as a percentage of usage rose to 73.55%, up just a tad from February, and down from 85% and 76% in 2015-16 and 2016-17, respectively.

One key item was the revision to US exports. Bears have been skeptical about demand in general, partly because of the huge global stockpile and partly because of competition from synthetic fibers. To the extent that US foreign sales are a harbinger for global consumption levels, demand is surprisingly strong.

US export commitments stand at 14.2 million bales, up close to 20% from this time last year. That means that exporters have contracted to sell just about as much as the USDA forecast for the whole marketing year, which runs until July 31. Even after the USDA's 300,000-bale upward revision to 14.8 million bales, the estimate seems conservative. The way sales have been going, it will take only a few more weeks to meet the USDA target.

The diagnostic that bulls should be looking at, though, is not how much has been sold, but rather how much has been shipped. And there is some cause for concern there. As of the most recent reporting period, shipments of 7.08 million bales are lagging last year's pace of 7.5 million bales. Whatever does not get shipped will be carried forward to the 2018-19 balance sheet. Weekly shipments in March 2017 averaged 414,000 bales, while this year the weekly average has been 454,000 bales. If shipments do not tail off, there should be no problem meeting the USDA estimate.

Taking an even closer look at US exports, the pace of Chinese buying has slowed. When we last wrote about cotton (see *Focus on Futures*, January 18), total shipments and outstanding sales for 2017-18 were running 39% above 2016-17, but that figure is now ahead by only 19.5%. That could be viewed as a disappointment.

On the other hand, there is a silver lining in that cloud. If China has scaled back its purchases of US cotton and the numbers are still large, then the buying is coming from a broad array of countries and could mean that the dependence on Chinese buying going forward is not as crucial as it used to be for US exporters. In addition, China has included cotton on its list of imports that will be slapped with retaliatory tariffs. If the US is no longer heavily reliant on exports to China, it takes some of the sting out of the move.

Looking ahead to the upcoming 2018-19 marketing year, the crop picture is mixed. The first USDA planting intentions report of the season on March 29 forecast US cotton area at 13.46 million acres, higher than the average of analysts' guesstimate of 13.29 million acres. That's up from 12.61 million acres planted for the 2017-18 crop. The market barely reacted (Chart 5).

At issue is the weather in Texas, the nation's largest cotton growing state. Dry weather has prevailed thus far. Analysts say that if we do not see a significant improvement, it will be very unlikely to meet last year's near-record yields of 889 pounds per acre. So higher acreage does not necessarily mean more output.

China is in a similar situation. Planted area is set to expand, but it will be a challenge to duplicate last year's yields.

For 2017-18, India was the world's largest producer with 28.5 million bales. Disease has been a significant problem, which will result in a material shift to soybean planting. Analysts say that farmers will plant 12% less cotton for the 2018-19 crop.

The market has been consolidating since January. Should global demand remain strong without any growth on the supply side, we anticipate a resumption of the bull run that began in early 2016 (Chart 6).

Maintain long positions in December cotton as per our January 18 recommendation. Raise stops to 73¢ per pound, close only. *[By Sholom Sanik, April 4, 2018]*

Chart 5 – December cotton

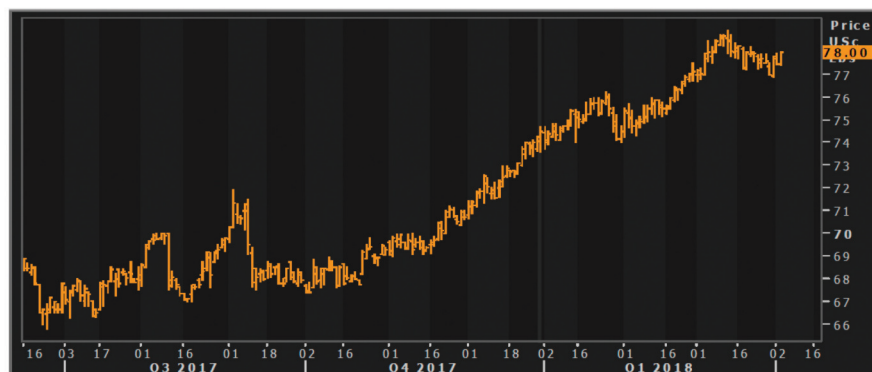


Chart courtesy Reuters

Chart 6 – Weekly cotton, nearest contract

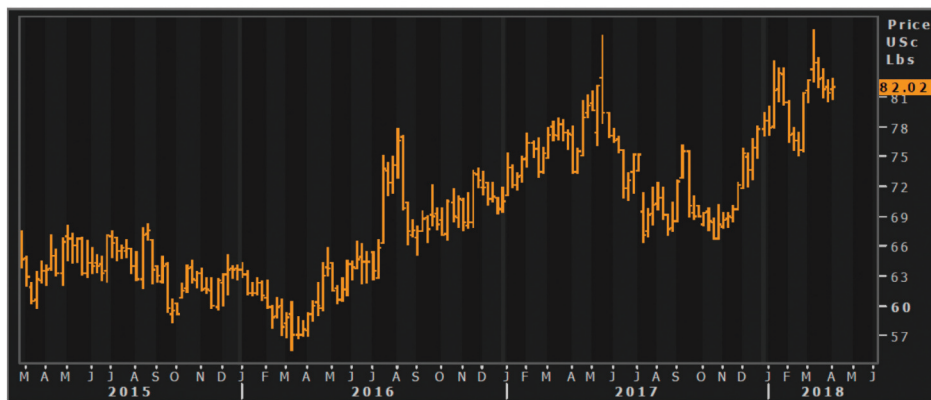


Chart courtesy Reuters

COCOA

Ivorian cocoa arrivals play catch-up

In mid-2017, while the Ivory Coast was on its way to harvesting a record crop of more than 2 million tonnes for the 2016-17 marketing year, cocoa prices traded down to six-year lows. After consolidating for the balance of calendar 2017, the market tested the lows in mid-December, but then skyrocketed by \$800 per tonne, or close to 50% (Chart 7).

The surge was motivated by the belief that Ivorian output would not duplicate the stellar results of 2016-17 for the current season because weather conditions heading into the March-through-September mid-crop were not ideal. Just a few weeks ago this certainly seemed to be the case – 2017-18 port arrivals were running about 72,000 tonnes behind the same time a year earlier. However, the most recent data published by exporters show that the gap has narrowed materially, to only 29,000 tonnes. The stronger production outlook provided a backdrop for a \$200-per-tonne setback.

Although volumes were running behind the previous year's for a good part of this season, when viewed in isolation, arrival levels were still moving at a pace that will probably leave total output as the second-largest crop on record. But there was another factor at work that had been driving cocoa prices up – poor quality. In February, reports were circulating that the metrics used to determine export suitability were showing the worst results in years.

The acceptable standard for beans slated for export is 105 beans per 100 grams, but a sizeable part of the crop was showing 130 beans per 100 grams. Furthermore, the passable level for free fatty acids in beans is 1.75%, but

here again, bean quality was shockingly poor with levels between 5% and 7%. There are no current data on these issues, but back in February there was a period of several weeks when both local grinders and exporters are said to have rejected as much as 70% of all beans inspected. So the pickup in arrivals might be somewhat deceptive.

Other important producing nations have not picked up the slack, with lower output for 2017-18 seen in Ghana, Cameroon, and Indonesia. Nigeria was expected to have a better crop than last year, but proper data are few and far between, so it's hard to know whether early forecasts are living up to their promise.

On the demand side, butter prices have softened a bit, but remain steady. Powder prices have drifted lower, though, bringing the combined butter/powder ratio down from multi-year highs (Chart 8). Grinding figures for the first quarter are due out throughout April, so we'll get a look at what effect strong product prices had on demand.

The uncertainty surrounding the Ivorian crop – the single most important issue for this market – could keep this bull run alive.

On February 9 we suggested establishing long positions in July cocoa on a pullback to the \$2,000-per-tonne level, with an \$1,800 sell stop. The subsequent inter-day low was \$2,019. Should you have been fortunate enough to buy it, we recommend maintaining the position. Raise sell stops to \$2,400, close only.

[By Sholom Sanik, April 11, 2018]

Chart 7 – July cocoa

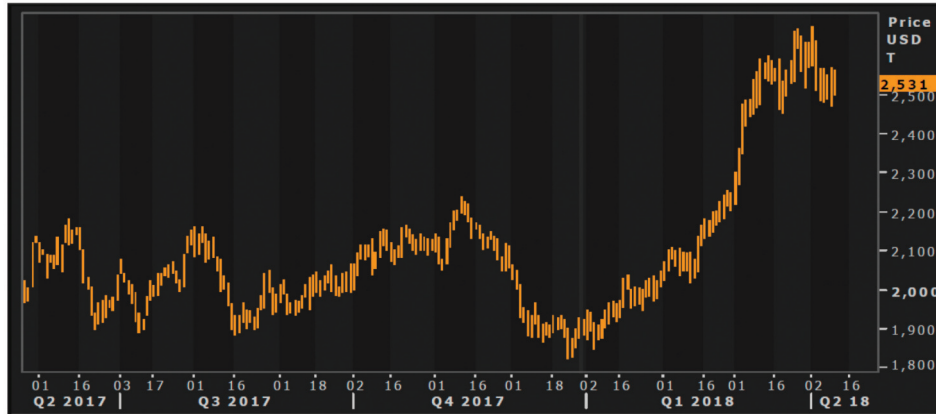


Chart courtesy Reuters

Chart 8 – Combined cocoa butter/powder ratio

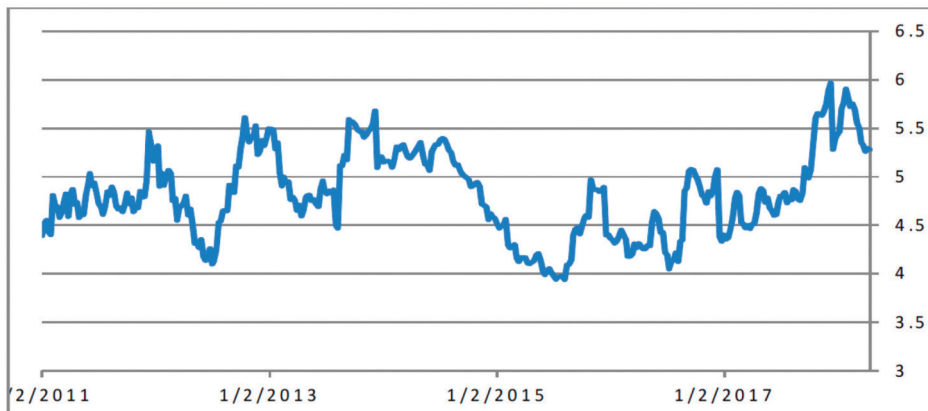


Chart source: Reuters

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