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Sweeten your portfolio

Few commodities these days can lay claim to the distinction of being within earshot of their contract lows. Most markets have largely recovered from the Asian crisis. The sugar market has seen no recovery. Even while consumption resumed at more normal growth rates for most commodities – including sugar – sugar prices continue to make new lows. And it's no mystery.

The 1993-94 season was the first time in years that sugar production dropped. The drop in output lifted sugar out of a deep depression. Prices doubled between 1993 and 1995 to 16¢ per pound from 8¢. The following season, however, saw output leapfrog back to the record levels of 116 million tonnes set in the 1991-92 season, kicking off an even more severe bear market from which the market has yet to recover. From the 1993-94 season and onward, production has grown by an average of 3.4% per annum, while consumption has grown by only 2.6% per annum. Carryover stocks piled up throughout this period. Stocks as a percentage of consumption at the end of the 1993-94 season were only 17%. According to the latest USDA figures, they now represent 26% of consumption. The obvious conclusion is that the world is awash in sugar.

Well, the world is awash in many commodities, and still we've seen some of these markets enjoy substantial rallies before any improvement in the fundamentals became apparent. We believe that the sugar market is at the beginning of such a process. We can establish that the market is underpriced, particularly when we view prices in the context of the cost of production. Many countries provide sugar growers with subsidies to protect their domestic industry. There are many countries, however, that do not and where producers are either eking out tiny profits or are actually losing money. (Australia is a good example.) The cost of production varies across the globe, but falls loosely into an average range of 5¢ to 6.5¢ per pound. With prices spending most of the past year between 4.5¢ and 6.5¢ per pound, the incentive to grow sugar, as opposed to alternative crops, is not huge.

The first indication that we may be at the end of the bear market cycle, where the rapid rate of output growth ends and steady consumption trends are given the chance to eat into burdensome stockpiles, came last week. The International Sugar Organization (ISO) revised its estimate of the world sugar production/consumption balance to a surplus of 3.59 million tonnes from its previous estimate of a 4.76-million-tonne surplus. This is down from last year's surplus of 6.51 million tonnes. It estimates that production will fall slightly for the first time since 1993-94 to 134.17 million tonnes from last year's 134.57 million. Consumption, on the other hand, will rise by 2.5 million tonnes to130.50 million tonnes.

In the text of the report, the ISO points out that its new set of figures "does in no way change the fundamental picture, which remains seriously over-supplied." We couldn't agree more. Indeed, plugging these statistics into the supply/demand balance would still leave us with carryover stocks that represent 25% of consumption.

From a trading perspective, however, we look at the situation a bit differently. The market has begun to provide us with concrete data – skimpy as they may be – that the tide has turned. We have not seen much evidence of voluntary production cutbacks. In fact, one of the most significant losses of production was caused by frost in China that caused output

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Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.

from the southern cane growing regions to fall by 1.7 million tonnes. But we do see that a little accident here and there, coupled with a 2.5-million-tonne increase in demand, can quickly turn surpluses towards balanced markets that can then slip over the line into deficits.

With prices so near their bottom, we ask ourselves: Can the price of sugar be the same for a 6-million-tonne surplus as it would be for a 3-million-tonne surplus? The fundamentals of the commodities that had rallies looked equally bleak at their lows. A short list of examples would include petroleum, soybeans, and hogs. Astute traders who smelled the turn before it was in plain sight reaped the profits. We feel that the combination of slightly improved fundamentals and the fact that prices have collided with the cost of production puts us close the bottom of this market. *[March 29, 2000]*

CURRENT STRATEGY: *Remain long July sugar as per Flash Update of March 24. Raise stops to 575, close only.*

Chart 1 – July Sugar

chart courtesy of *REUTERS*

GRAINS

Watching developments

Corn

In the days leading up to the March 31 planting intentions and quarterly stocks reports, traders took – as they call it in the grain industry – protection. Improved precipitation in the Midwest raised moisture levels and erased the forecast for dry weather that was responsible for the sharp rallies in the corn and soybean markets. Corn prices, the focus of our attention of late, took a fairly big hit, dropping 17¢ from their peak. The weatherman did not cooperate, however, and cornfields were deemed to have received only inadequate amounts of moisture. Accordingly, the session preceding the big crop report saw a hefty 6¢ rally, leaving prices smack in the middle of the recent "weather range."

Then came the report, and it was not bullish. The USDA estimates that farmers intend to plant 77.88 million acres of corn. This was higher than the average trade estimate of 77.5 million acres and higher than last year's 77.43 million acres. Quarterly stocks stood at 5.606 billion bushels, which was higher than the average trade estimate of 5.57 million bushels. Together, the higher-than-expected potential production and the increased stocks will add about 85 million bushels to this year's US carryover stocks. Based on the last USDA supply/demand report, stocks were 18.3% of consumption. These two reports will raise this figure to 19.2% of consumption.

The market's reaction was a bit unusual. Prices were higher at the opening bell and remained strong throughout the session, as traders chose to remain focused on forecasts for continued dry weather. Well, if futuristic weather news wins over concrete bearish news to take the market higher, what should we be looking at for future direction?

Although exports have been chugging along at a reasonable pace, they have not been outstanding. In our last report

on corn (February 25) we said that we need to see export commitments in the order of one million tonnes per week to make the export picture look constructive. This past week, the US sold 780,000 tonnes of corn for export, which was weak compared with the average of 942,000 tonnes for the previous four-week period. Exports must pick up if this rally is to be sustained.

The huge buildup in the open interest goes a long way to explaining the strength of this move. Small speculators and commodity funds love the cheap corn story and have poured into this market *en masse*. Open interest sits at 500,000 contracts, having tacked on some 50,000 contracts in just the past two weeks. The market needs a sizable washout to rid itself of the weaker hands. If this market is for real, we should be able to accomplish this feat without major damage to prices. Our reentry strategy will be based on the health of the export market and signs of liquidation in the open interest.

CURRENT STRATEGY: *Remain long as per Flash Update of April 14, maintaining stops at 228, close only.* *See our more recent article on Page 10.*

Wheat

While corn prices were challenging their highs in recent weeks, wheat prices were busy challenging their lows. However, unlike corn, the acreage and stocks reports were quite bullish. The USDA estimates that farmers will plant spring and winter wheat crops on only 61.7 million acres, which was lower than the average trade estimate of 62.0 million acres and lower than the 62.8 million acres planted last year. This is especially significant, because we already know that the winter wheat crop planted last fall was smaller for the second year in a row. This will, then, mark the third year in which US farmers planted smaller wheat crops, which establishes something of a trend. The long period of low prices and low profitability is finally affecting output.

Quarterly stocks totaled 1.412 billion bushels, higher than the street's average guess of 1.45 billion bushels.

The weakness we've seen in wheat these past few weeks represents no great puzzle. Exports have really dried up. Last week's commitments were only 273,000 tonnes. The average commitments of the previous four weeks was 417,000 tonnes, which was also very limp. If exports were to continue at this pace, the USDA's estimate of 1.05 billion bushels for the season looks awfully optimistic. Although the wheat market probably deserved the thrashing it received, it was oversold. World carryover stocks have been declining for a couple of years and prices are low relative to historical levels. The new data tell us that demand has likely been somewhat better than the information we've been fed and that production will remain flat, at the very least. We still believe that the market is in the process of forming a long-term bottom. It is unlikely that prices will make dramatic new lows. At the same time there is little evidence to suggest the export market is going to recover enough to propel prices much higher. We remain watchful but sidelined. *[March 31, 2000]*

CURRENT STRATEGY: *Remain sidelined in wheat.* *See our more recent article on Page 9.*

COCOA

Still abundant, but, demand improving

It is now two years since cocoa prices peaked at $1,750 per tonne. Even while many internationally-traded agricultural commodities were staging rallies – some with fundamentals not much better than cocoa's – cocoa prices continued to decline, taking out the 1992 low of $780 per tonne and sinking to prices not seen in 27 years. A recent push that saw the market flirt with the $900-per-tonne level fell flat, and prices retreated below $800 per tonne.

Still, the market has made little downside progress since prices dipped below $800 per tonne back in November. In fact, a more optimistic viewpoint – okay, a *very* optimistic viewpoint – might be that we're in somewhat of an mini-uptrend that started from the $730-per-tonne low we set in late February (Chart 2). Such basing action gives us technical, albeit superficial, grounds to ask: Is there anything at all in the supply/demand fundamentals to warrant a stab at the long side of this market?

The world's largest producer, the Ivory Coast, will harvest a record 1.3 million tonnes this year. The most recent statistics released by E.D.&F. Man indicate that the large crop will translate into a production/consumption surplus of about 100,000 tonnes, up from its January estimate of 73,000 tonnes. World production will grow by 42,000 tonnes, or 1.5%, to 2.995 million tonnes. Grindings will increase as well, but only by 17,000 tonnes, or .5%, to 2.868 million tonnes. Naturally, the surplus will serve only to exacerbate the downward pressure on prices already being exerted by the burdensome inventories that amount to 44% of consumption. There isn't very much in these figures with which to build a bullish case.

Last week, first-quarter grinding statistics were released by three of the four large Western grinding countries, and overall they were quite positive. The only disappointment came from the UK, where the grind was down 2.2% compared with the first quarter of 1999. Of the four countries, however, the British have the smallest grind. The German grind, which was expected to rise only slightly after falling 22% in the same period last year, rose 8.1%. This was especially encouraging from a country where grindings are in prolonged downtrend, having dropped by about 30% since 1992.

The Dutch numbers are the most significant because

they grind more than British and Germans put together. Market expectations called for the Dutch grind to be about the same as last year's first quarter, but it actually rose by 6.8%. Among the three countries, grindings rose 5%.

Certainly, this makes the demand picture look much stronger than the statistics available to E.D.&F. Man upon which it based its last report that estimated first-quarter grindings to grow by only 3%. The first-quarter tally of the world's largest grinder, the US, is due to be published on April 28. If it is anything close to analysts' expectations of a 10% rise, we might have something of a confirmation that consumption has turned the corner.

We must also bear in mind that because much grinding activity is shifting to origin countries, an increase of any size in the traditional grinding countries is a bonus and should be considered bullish. Brazil, for example, saw its fourth-quarter grindings rise 4.4%. Origin countries now account for about 35% of world grindings compared with 32% in 1997.

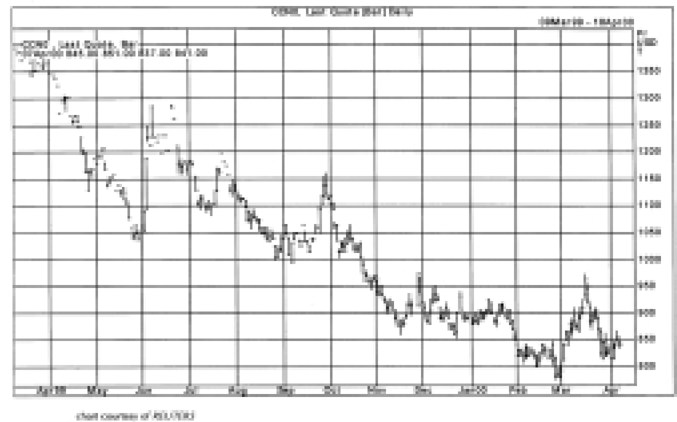
Producing countries are fed up with falling prices and are resorting to some desperate measures. The Ivorian military government is banning the export of lower-quality beans (beans with a bean count of more than 100 per 100 grams). Analysts estimate that affected beans could amount to as much as 100,000 tonnes, or roughly the global production/consumption surplus. The effect of the decree is probably not potent, because it is assumed that the unexportable beans would be ground locally and ultimately find their way to the world market. Then the government announced that it would burn the beans that don't qualify for export. Again, it is questionable whether this will happen. Nevertheless, we see it as anecdotal evidence that the low prices are hurting countries whose economies rely heavily on the revenue they generate from their primary crops.

So, yes there are grounds to consider getting bullish. Supplies may be ample, but the demand that has been absent may be returning. Prices are very cheap by historical measures but may not remain so for very long if buyers return. Some items to watch for include a US grind that meets or exceeds expectations and confirmation that original estimates for an Ivorian mid-crop of 250,000 tonnes were on the high side. We're on the sidelines, but watching eagerly.

[April 12, 2000]

STRATEGY: *Stay closely tuned.*

Chart 2 – July Cocoa



MARKET ANALYSIS

Don't be fooled

As the market's recent "correction" gathered speed, you have no doubt heard – from ostensibly unimpeachable sources – that a buying opportunity was at hand. Buy the dip, was the advice, and you will become rich.

Think about it, though. Who are these so-called experts, and what do they know that you don't? They are Wall Street (Bay Street) types – people who have become wealthy peddling wares and buying stocks in this, the greatest bull market in human history. They are people whose very livelihood depends on a continuation of this bull market. How objective can they be? If it is difficult for these people to issue a single sale recommendation (less than one percent of all recommendations), how much more so it is for them to tell you to cash your chips and put all your money in the bank? If they would testify in a court of law, would you accept their testimony, or would you disallow it because of flagrant conflict?

Think about it. Hundreds of Nasdaq (and many TSE) stocks fell more than 60% in recent days. Did any of these Wall Street experts warn investors of such a painful loss of capital? The answer is a resounding no. A kind interpretation is that they did not expect these losses to occur either. What, then, qualifies them to pass judgment about the reasonableness of the aggregate of stock prices? Are aggregate judgments easier to make than individual ones?

It has been said that more fortunes were lost in 1930, buying on the decline, than in the crash of 1929. There was a fundamental difference between the two events: In 1929, investors were acting out of greed. Their fall was swift and in some cases fatal. Yet their ardor was cooled, and many foreswore forever the easy life. Their first loss was their last one. Not so for those who thought themselves smart enough to buy on the dip. They viewed themselves as particularly smart, a cut above the average investor. They became stubborn, throwing good money after bad. In the end, they were wiped out.

Clearly, there are times when it pays to panic, and there are times when it pays to stay cool. How to tell when? For one thing, if you have a margin call, *do* panic. Let the market be the judge of what you can and what you cannot afford. Meeting margin calls is a prescription for financial disaster.

Take it from someone who has seen, experienced, and issued thousands of margin calls in his career. What if you have not borrowed from the broker or bank and in fact are quite comfortable owning a fully-paid portfolio of securities? Ironically, you are in worse shape than the leveraged investor. There will be no broker to force you out. It will be entirely up to you.

In reassessing your situation you will want to answer a number of questions: Did you buy because of momentum? If the momentum has reversed, which is quite likely, sell. Did you buy because of earnings? Make sure that the earnings exist and that you are not paying a multiple greater than one or one and one half times reasonably expected profit *growth*.

Most importantly, detach yourself from the Alice-in-Wonderland mentality of the past six months and ask yourself, Would I buy shares in such a business if it were private, knowing that the shares were not listed, and expecting to see a return on my money from profit distributions only? If the answer is no, sell the stock.

The fact that the company is public will not improve the equation. If anything, a public listing will reduce your equity and thus your expected returns, because of the enormous dilutive effect of stock options so freely granted to company executives, directors, and employees. (The granting of these options has been possibly the greatest abuse of investors' trust and money in modern history.)

If your money is in a mutual fund, check the portfolio carefully, and make sure it meets the above criteria. Just as importantly, check the liquidity of its holdings. Can the fund liquidate its portfolio over a few days? If the fund does not meet your investment criteria and/or if the great majority of its holdings is not liquid (a quick rule of thumb: shares held should not exceed twice average daily volume; bid/ask spreads should not exceed one quarter of one percent), be prepared to redeem your units.

To understand the recent plunge and to understand where the market is headed, you need to understand the dynamics that fuelled the historic rise. The bull markets of the '80s was, for the most part, a catch-up phase to the 17-year-long bear market that preceded it. Asset prices and earnings power had increased during the great inflation of the '60s and '70s; falling inflation rates and falling interest rates helped to catalyze investment values. Again, for the most part, share prices rose in tandem with the proportional fall in interest rates. By the early '90s, stock prices had caught up to their intrinsic values.

The next phase, the speculative phase, was the product of two coincident factors: easy money, created by the Federal Reserve to bail out the S&Ls and the major banking institutions in the US, and the paternalistic handling – on the part of the US Treasury and the IMF – of the three or four major financial crises of the past five years. Investors were reassured that come what may, they will be bailed out. With increased moral hazard came an explosion of leverage and a speculative orgy. The rest is history.

What has changed? What no one had expected in the New Economy: Easy money has finally impacted inflation rates. For the past year, inflation has risen to an annualized rate of 3.7%. The rise in services and core components such as housing carries ominous implications: Inflation is becoming entrenched. The Federal Reserve (and other central banks, too) has effectively lost maneuvering room and may no longer be in a position to bail out failing institutions with the impunity of yesteryear.

The engines of the bull market are sputtering out. Easy money is on its way out, and officialdom seems to have recognized the limits to paternalism, a paternalism that brought about the greatest wave of irrational exuberance in recorded history.

Don't be fooled. Buying on the dip *can* be hazardous to your finances. *[April 17, 2000]*

– A.D.F.

CANADIAN DOLLAR

Is *True North* heading south?

The Canadian dollar has spent most of this year bouncing back and forth between 68¢ and 69¢. On its most recent visit to the bottom end of the range, it broke that long-standing support level as well as the uptrend that dates back to September 1998 (Chart 3). Is the recovery of this currency in jeopardy? Are we going to challenge the 63.5¢ lows?

Little has changed in the way of economic trends since our last discussion of the Canadian dollar in February. Economic indicators that need to be supportive of the dollar have been. The January merchandise trade balance released on March 21 increased to a record $4.53 billion surplus, topping the previous record set in May 1996. At $1.79 billion, the jump in the monthly surplus was the biggest increase since the surplus began to grow in October 1998.

The much broader measure of capital flows, the current account, suffered a setback in the latest period. After rising steadily since the first quarter of 1998, the current account balance for the fourth quarter slipped back into negative territory. The drop was small, however, relative to the range of the past two years. Considering that the deficit narrowed from $16.4 billion at the of 1998 to $4.3 billion at the end of 1999, it was certainly not an alarming development. The remedy of a cheap currency seems to have worked, even though the Canadian dollar has been strong for the past one and a half years.

There have been some headline-grabbing political events

that probably caused some discomfort for foreign investors. The uncertainty surrounding the future role of Finance Minister Paul Martin – the slightly right-of-center anchor in the slightly left-of-center government – caused a bit of a stir. Both Canadians and foreigners consider Mr. Martin to be the fiscally-responsible, voice of reason in a government that is otherwise free-spending. Some in-fighting in the upper echelons of the ruling Liberal party regarding Prime Minister Jean Chrétien's future as party leader also created an air of instability. These issues have faded from the spotlight but have drawn a crowd of short sellers, which is evident in the sudden bulge of 15,000 contracts in the open interest.

We continue to view the spread between Canadian and US short-term interests rates as the primary issue that should ultimately determine the direction this currency takes. Investors have made it clear that they must be rewarded for holding Canadian dollar deposits. The Bank of Canada has also made it fairly clear that it will keep pace with the US Fed and its series of interest rate hikes. There has been little indication, though, that it would become any more aggressive than the Fed.

Last week's stronger-than-expected US inflation numbers for March reinforced traders' notions that there would be no letup in the Fed's tightening program. The core rate came in at .4%, higher than the .2% analysts were expecting. Yesterday's release of the Canadian core CPI rate showed much the same pattern of rising prices, gaining .4 percentage points. Actually, it was slightly below analysts' expectations, and the annual rate dropped from last month to 1.5%. This is the rate the Bank of Canada watches for in its 1%-to-3% inflation target band. The better-than-expected performance – poor as it might have been – leaves observers with a sense of complacency that the Bank of Canada will continue to move in lockstep with the Fed. Hence the Canadian dollar's woes.

The spread between the two countries' short-term rates has hovered between 80 and 90 basis points (bps) in favor of the US side since the beginning of the year. The spread has firmed up a tad in the past few weeks to 82 bps. We believe that the downdraft we are currently experiencing in the Canadian dollar has overshot the economic fundamentals that are significant to the currency. The puncture of the support zone and the uptrend have loaded the boat with trend-following shorts, and that has exaggerated the drop. We remain convinced that the long-term direction of this currency is up, based on the following: the strong economy; fiscal health at the federal and provincial levels; and resurgent demand for commodities that will replace the need for a cheap currency to make Canadian natural resources attractive.

We've taken the plunge with a long position. We anticipate that the fundamentals will assert themselves sooner rather than later in the form of a narrower differential between US and Canadian short-term rates of below 70 bps. This will set off a rally that will send the dollar to new recovery highs. *[April 18, 2000]*

STRATEGY: *Remain long June Canadian dollars as per Flash Update of April 13. Maintain stops at 67.05, close only.*

Chart 3 – June Canadian Dollar

SOYBEANS

Export demand is back

The "Strategy" section of the January 21 issue of *Focus on Futures* advised, "The corn and soybean picture has probably changed enough to be a buyer on dips." The soybean market did trade lower subsequently, but for the most part has since been in a steep uptrend and rather stingy with dips (Chart 4). Beans have now rallied 35% off their exhaustion lows of $4 per bushel set almost one year ago. Viewed from this angle, they seem expensive. From an historical perspective, though, prices are still depressed (Chart 5). Do the fundamentals warrant a continuation of our "buy-the-dip" recommendation?

Demand for feed grains and protein meals grew this past decade primarily because the new consumers in Asia have adopted Western eating habits and have been eating more meat. Growth in soybean consumption was particularly dramatic. To illustrate, consider that annual global corn consumption grew has grown by 11% since 1995. Soybean consumption grew by 20% in the same period. Global output of soybeans during this period grew as well but by a smaller 18.5% per annum. Prices were as high as $7 per bushel as recently as early 1998. Then the Asian crisis hit hard, and both production and consumption leveled off. The vigorous pace of export demand that drove prices tapered off as well, allowing stocks to rebuild and prices to fall.

The soybean meal portion of the protein meal market (63%) is much greater the soybean oil portion of the vegetable oil market (28%). Still, it is obviously constructive for prices when both products are sought after. This helps, in part, to explain the bear market we've witnessed in soybeans from 1997 through 1999. Despite the fact that consumption of soymeal continued to grow each year, even during the Asian crisis, soyoil did not and acted as a drag on the market.

As demand for soybean meal reached a feverish pace, US processors scrambled to meet that demand. Since oil is produced from soybean crushing whether you need it or not, a glut developed. This glut could not have come at a worse time. Malaysian and Indonesian palm oil crops began to recover in early 1998.

Stimulated by high prices, production of rapeseed oil grew by 10% from the 1997-98 crop year to the following season. US export commitments for soybean oil of 328,400 tonnes thus far this season are *less than half* last year's commitments. This can be partially explained by the fact that China is protecting its domestic crushing industry with import taxes and is simply importing more beans.

The USDA estimates that China will import 5 million tonnes of beans this year, a 24% increase over last year. Still, total global beanoil consumption will remain flat to slightly lower and will continue to be a negative factor for bean prices.

So the question becomes, What are the fundamentals in the other half of the complex, and are they bullish enough to overwhelm the lackluster interest in beanoil?

The pace of US export commitments definitely supports the notion the demand is back. As of the end the most recent reporting period, US soybean export commitments total 23.02 million tonnes, compared with 19.66 million tonnes at the same time last year, a 17% increase. Given that China is crushing more beans at home and therefore importing more beans, one would think that this comes at the expense of global soymeal exports. Not the case. Soymeal commitments – at 4.64 million tonnes – are steady, running only 2% behind last year's pace of 4.74 million tonnes.

It all shows up on the bottom line. The USDA has consistently lowered its forecast for US ending stocks this season. The current estimate for ending stocks of 305 million bushels represents roughly half the estimate the USDA began with at the start of the season. Ending stocks as a percentage of consumption are only 11% compared with 13% last year.

The market has spent much energy focusing on the weather. Early planting-season dryness supported prices. More recently, better precipitation has pushed prices of July beans back some 20¢ per bushel off the $5.66 per bushel set in early April. We cannot predict the weather and beans can be planted right through the middle of the summer. Thus, the supply issue will not be settled for months.

We are clear on the demand side of the equation, though. Exports, as illustrated, are strong. Competition from the Brazilian crop, which is now available for export, has shown up in slackening US export commitments since the end of March. Despite this, commitments to date indicate that the USDA export target for the whole season is not only well within reach, but could easily be topped with a continuation of even the current slow pace of exports of about 250,000 tonnes per week.

Yes, we believe the fundamentals are bullish, and we continue to look for an entry point that is supported by technical factors, such as moderate sentiment readings, so that we don't find ourselves running with the crowd.

[April 30, 2000]

STRATEGY: *Stay closely tuned.*

Chart 4 – July Soybeans

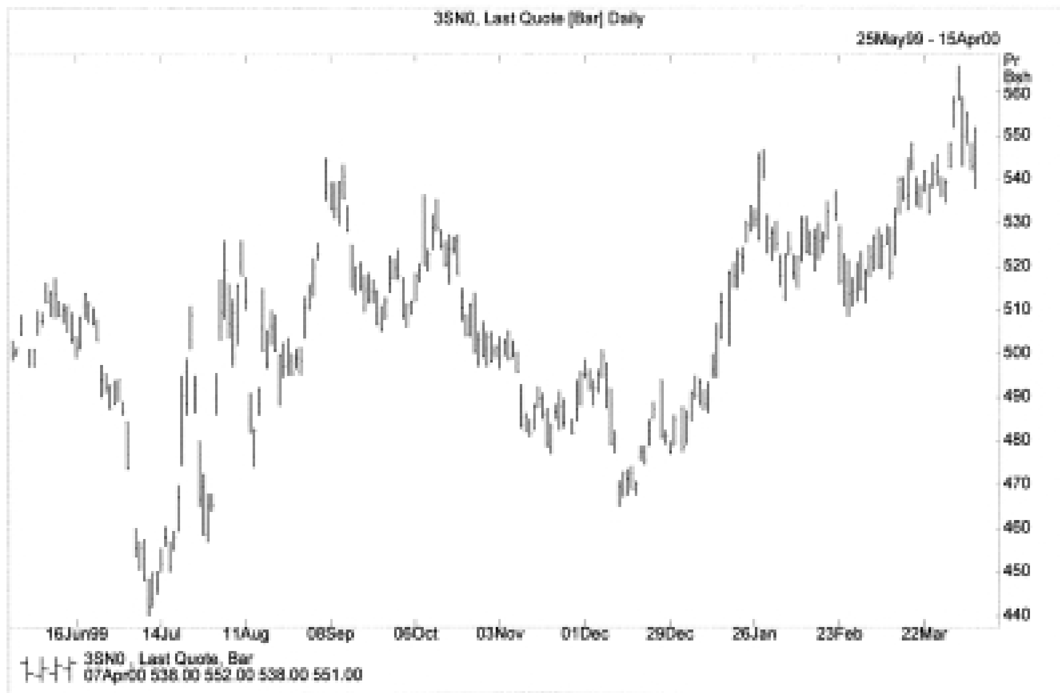


Chart 5 – Monthly Spot Soybeans

WHEAT

Are these fair prices for wheat?

July wheat made a new contract low last week. Are the fundamentals of the wheat market so bleak? Does its price deserve a fate on par with a commodity like, say, cocoa. Which has carryover stocks equal to almost half its consumption and also one that made new contract lows last week?

We agree with the near-term assessment of traders and analysts in that recent developments in the US, both on the supply and demand sides, have not been constructive for prices. Although the winter wheat crop was slated to be smaller for the third year in a row, recent rains have improved the crop's prospects. Some analysts have even gone so far as to predict that we will move from an early season expectation of a winter crop that would be slightly smaller than last year's to one that is slightly larger.

Despite the fact the most recent crop condition report (April 23) showed that winter wheat in good to excellent condition had dropped to 61% from 62% the previous week, the market has begun to dismantle the premium it had installed in prices for a disappointing winter wheat crop.

The export market has fallen asleep. Last week's weekly export commitment report was something of a disaster for wheat. Net new sales for the period were 212,000 tonnes, which was at the low end of trader's estimates. Average weekly commitments for the previous 4-week period were 356,000 tonnes, which was poor as well compared with the average of the 4-week period before that of 417,000 tonnes per week.

The USDA was quite optimistic in raising total US exports for the year in its April 11 supply/demand situation report by 25 million bushels to 1.075 million bushels. We suspect it will recant on this item in its upcoming report on May 12. Total commitments for the year thus far of 25.66 million tonnes are running behind last year's pace by 2.5%.

Cheap prices and strong economies have failed to stimulate demand for US wheat. It seems unreasonable, then, that the USDA will stick to its estimate for exports to finish the year above last year's level. It would be clear, therefore, that the US picture is bearish.

The global scene, however, looks different. The supply/demand balance continues to tighten with each month's USDA report. In the April 11 report, estimates for production were increased by 1.4 million tonnes, while those for consumption rose by 2.7 million tonnes. This will lower ending stocks slightly from last month's estimate to 125.8 million tonnes, or 21% of consumption.

To put this in a proper historical perspective, consider that the average global carryover stocks for the 1990's was about 23% of consumption, with 1992-93 being the most abundant season of the decade with a carryover of 26% of consumption. Prices ranged from $2.5 per bushel to $7 per bushel, but spent most of the decade between $3 and $4 per bushel (Chart 6). The trend of global ending stocks is the best indication we have of what's happening with the balance between supply and demand. Inventories have been trending downwards and are at the low end of the range of recent history. It is somewhat puzzling, then, that prices should be trading at the lowest levels of the period in our discussion.

Naturally, there are plenty of logical explanations. The US dollar is stronger now than at any time in the 1990's, which should put pressure on the prices of internationally traded commodities that are priced in dollars. Improved mobility has given consumers of commodities confidence to rely on just-in-time inventory systems. This makes comparisons with inventory levels in earlier periods somewhat inaccurate. Indeed, these factors represent realities that we must consider in an ever-changing global economic scene.

Nevertheless, we think that low prices are an aberration and do not account for the underlying trends in the wheat market. Since 1995, global wheat production had only one spectacular year – 1997-98, when farmers grew 609 million tonnes, compared with 587 million tones this year. Other than that year, the wheat market has actually been quite unlike other markets in that it did not participate in a production boom. Since that season, production has declined every year. It is the excess output of that year that we are still working off.

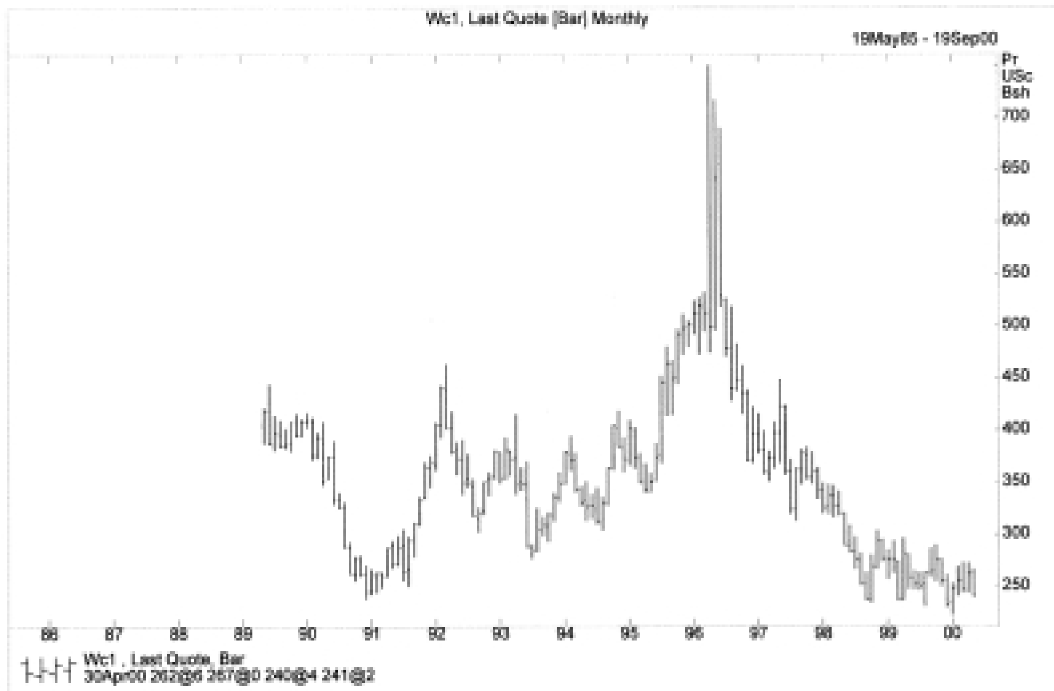
By contrast, consumption has grown steadily each year in the last half of the 1990's, with this season being no exception. There is no reason for us to suspect that the trend of lower production will change. Output fell because of low prices, and we still have just that: low prices. Consumption, on the other hand, has grown because the world's population has grown, and people must eat.

In conclusion, we understand why there are eager sellers out there. The data at hand are not bullish. On the other hand, the big picture, as illustrated, is being ignored. Traders are interpreting the numbers correctly, but are not paying attention to the price levels at which they are dumping wheat.

[April 30, 2000]

STRATEGY: *We don't want to fight the tape, but we do advise staying tuned.*

Chart 6 – July Wheat



CORN

Long-term bullish outlook is intact

Corn prices have been influenced by weather, and it seems nothing else. After a 3-month rally from the pitiful $2 per bushel level to a more respectable $2.50 per bushel, the market has been drifting lower. The strength earlier this year came from both worries about supply and resurgent demand. The US Midwest was not receiving the desired precipitation to build adequate subsoil moisture levels required for spring planting. Coupled with a buoyant export market, prices were off and running.

Recently, however, rain has appeared, and the panic surrounding forecasts for a hot, dry spring has subsided. Prices are pressing against the bottom end of the recent range. Talk among analysts is that the rally was held together by the weather concerns and the lower yields that would follow. Where do we go from here?

Unlike the recent performance of wheat exports, demand for corn by foreigners hasn't skipped a beat. Last week's commitments totaled 1.25 million tonnes, which was 350,000 tonnes above the high end of analysts' estimates. It was also much stronger than the average of the previous 4 weeks' commitments of 865,000 tonnes. Commitments for the year are running at 39.1 million tonnes, ahead of last year at this point by 4.5%.

In its April 11 supply/demand balance report, the USDA saw fit to lower its estimate for annual US exports from its March estimate by 50 million bushels to 1.9 billion bushels. We believe that the export commitment data we've seen in the period following the April 11 report tell a different story. After all, the most recent purchases came at a time when prices were still quite expensive relative to where they've been for most of the past six months. Although price were off their best levels, it seems that foreigners pounced on the market on the first available dip.

One of the bearish factors often cited in the market is China's moving from being a net importer to a net exporter. Given the robust US export market, it does not seem that the newly available Chinese corn has posed any serious competition. In fact, there have been reports in which Chinese corn has arrived at other Asian destinations only to be turned back because of its seriously substandard quality.

At the global level, the production/consumption balance is constructive for prices, but not screamingly bullish. Production is estimated at 600 million tonnes, down from 605 million tonnes last year. Consumption, on the other hand, will jump significantly by close to 19 million tonnes to 601.6 million tonnes. Ending stocks in will drop only slightly – from 109.4 million

tonnes, or 18.8% of consumption, to 108.6 million tonnes, or 18% of consumption. This is because of the huge inventories carried forward from last year (109.4 million tonnes vs. 86.91 million tonnes at the end of 1997-98). The average global carryover of the past 5 years has been 15.7% of consumption. The healthy jump in demand is a step in the right direction, but for the moment, merely establishes a bullish tone.

We do believe that US exports are the key to this market, because they account for 60% of world corn trade. We have focused our attentions on this market because of this, and although prices have been sluggish, our motivation in the form of the pace of exports has been anything but. The attention that traders have paid to the weather has been premature. All the noise in the market has resulted in prices returning only to where they were in mid-January when the weather watch began.

The recent weakness has actually helped the market into a better technical position since it has shed about 50,000 contract' worth of open interest. Sentiment readings have softened as well. We continue to believe that the long-term bottom is in. *[April 30, 2000]*

STRATEGY: *Remain long July corn as per Flash Update of April 14. Maintain stops at 228, close only.*

HOTLINE UPDATE

Flash Update: **Thursday, March 30, 2000:**
Good morning for Thursday, March 30, 10:35 am. This is a Flash Update. We have rolled over our long platinum position, selling April at 474, and purchasing July at 467.

Friday, March 31, 2000:
Good afternoon for Friday, March 31, 5:15 pm. The following is a recap of our current open position recommendations and our latest stop levels. We are presently

- Long April CRB Index, with our stop revised to 208.65.
- Long June Swiss franc, with our stop at 5989.
- Long July sugar, with our stop at 5.07.
- Long July platinum, with our stop at 458.

All stops are close only.

Flash Update: **Friday, April 7, 2000:**
Good morning for Friday, April 7, 9:45 am. This is a Flash Update. We have liquidated our long July platinum positions at 468.

Friday, April 7, 2000:
Good afternoon for Friday, April 7, 5:15 pm. The following is a recap of our current open position recommendations and our latest stop levels. We are presently

- Long April CRB Index, with our stop at 208.65.
- Long June Swiss franc, with our stop at 6055.
- Long July sugar, with our stop at 545.

All stops are close only.

Flash Update: **Tuesday, April 11, 2000:**
Good morning for Tuesday April 11, 9:10 am. This is a Flash Update. We have purchased June gold at 283.50, placing our initial stop at 277, close only.

Flash Update: **Tuesday, April 11, 2000:**
Good afternoon for Tuesday April 11, 2:15 pm. This is a Flash Update. We haveliquidated long April CRB positions at 208.50. We repeat our Flash Update from this morning where we purchased June gold at 283.50, placing our initial stop at 277, close only.

Flash Update: **Thursday, April 13, 2000:**
Good afternoon for Thursday April 13, 12:55 pm. This is a Flash Update. We have purchased June Canadian dollar at 6805, placing our initial stop at 6705, close only.

Flash Update: **Friday, April 14, 2000:**
Good morning for Friday April 13, 9:55 am. This is a Flash Update. We have liquidated our long June gold position at 286.

Flash Update: **Friday, April 14, 2000:**
Good morning for Friday April 14, 11:30 am. This is a Flash Update. We have bought July corn at 237.5, placing our initial stop at 228 close only. We repeat our Flash Update from this morning where we liquidated our long June gold position at 286.

Friday, April 14, 2000:
Good afternoon for Friday, April 14, 5:10 pm. The following is a recap of our current open position recommendations and our latest stop levels. We are

- Long June Swiss franc, with our stop at 6055.
- Long July sugar, with our stop at 5.45.
- Long June Canadian dollar, with our initial stop at 6705.
- Long July corn, with our initial stop at 228.

All stops are close only.

HOTLINE UPDATE

Flash Update: **Tuesday, April 18, 2000:**
Good morning for Tuesday, April 18, 11:55 am. This is a Flash Update. We have liquidated our long June Swiss franc position at 60.55.

Flash Update: **Wednesday, April 19, 2000:**
Good morning for Wednesday, April 19, 10:15 am. This is a Flash Update. We have purchased June CRB Index at 241.50, placing our initial stop at 207, close only.

Thursday, April 20, 2000:
Good afternoon for Thursday, April 20, 4:45 pm. The following is a recap of our current open position recommendations and our latest stop levels. We are
• Long July sugar, with our stop revised to 5.75.
• Long June Canadian dollar, with our stop at 6705.
• Long July corn, with our stop at 228.
• Long June CRB Index, with our stop at 207.
All stops are close only.

Friday, April 28, 2000:
Good afternoon for Friday, April 28, 4:30 pm. The following is a recap of our current open position recommendations and our latest stop levels. We are
• Long July sugar, with our stop at 5.75.
• Long June Canadian dollar, with our stop at 6705.
• Long July corn, with our stop at 228.
• Long June CRB Index, with our stop at 207.
All stops are close only.

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