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Soybeans: can the uptick in exports absorb abundant supplies?

Recent USDA reports have sent traders mixed signals about the soybean market. The April USDA supply/demand situation report was an all around disappointment for soybean bulls. On the domestic side, traders were expecting a drawdown in 2001-02 ending stocks of about 10 million bushels; however, stocks were left unchanged from the March report, at 265 million bushels (7.22 million tonnes), or 9.2% of consumption. Still, this is still a fairly tight carryover. Over the past few years – while prices were falling – ending stocks averaged about 11% of consumption.

The US export marketing season is winding down. The USDA maintained its March forecast for annual exports at 27.76 million tonnes, just 2% ahead of last year's 27.21 million tonnes, despite the fact that both export commitments and actual shipments continue to run ahead of last year's pace. Total commitments stand at 26.12 million tonnes – 1.28 million tonnes, or 5%, ahead of last year. Of those sales, 23.27 million tonnes have been shipped, just under 1 million tonnes, or 4.4%, more than this time last year.

The torrid pace of sales we saw earlier this season tapered off in January. This explains why the USDA has not budged very much on its forecast for annual exports despite the fact that we remain ahead of last year in commitments and shipments. To illustrate, consider average new export sales over the past three four-week periods compared with the same periods in the two previous seasons (Table 1).

Table 1

	2001-02	2001-02	1999-00
Period 3 (most recent)	260,000	178,000	272,000
Period 2	231,000	391,000	456,000
Period 1	396,000	700,000	748,000

Periods 1 and 2 are substantially below seasonal averages. The past two weeks have seen very strong sales of 313,000 and 403,000 tonnes that were higher than both expectations and seasonal averages. This lifted the average for period 3 and provided price support to a market that seemed to be heading back to the $4.25-per-bushel neighborhood (Chart 1). In addition, there was a flurry of mid-week export activity last week that was not included in the weekly report, which ensures yet another solid commitment report later this week. Taiwan purchased 56,000 tonnes of beans, and 240,000 tonnes were sold to an unknown destination – split equally between old and new crop delivery.

The recent improvement in export sales may be something of a trend and explains – at least in part – why the market recovered smartly this past week. The export business over the past couple of weeks should be reflected in the May report. A 500,000-tonne increase in exports for the season would bring US ending stocks down below 250 million bushels (about 6.8 million tonnes). We can therefore assume bearish implications drawn from the monthly situation report have been mitigated with regard to export issues.

Looking ahead to the 2002-03 crop year, planting intentions, the other important report, was released on March 28.

In this issue

Unless otherwise indicated, all articles have been written by Sholom Sanik (E-mail: ssanik@friedberg.com).

The USDA estimated that US farmers will plant 73 million acres of soybeans, down 1.7% from last year, but more importantly, well below the average trade estimate of 74.61.

At the time, that figure seemed to complete a very bullish picture for the soybean market, with prices closing out that session with a fresh high for May beans dating back to last September. The optimism, it turned out was premature, because the low acreage forecast was predicated on the assumption that the new farm bill – which would reduce the loan rate for beans and discourage planting – would be passed before the planting season commenced.

Lawmakers in the House were haggling and it looked like the bill would not be passed in time to discourage planting, prompting analysts to raise acreage estimates back to their original forecasts of 74 million-plus acres. But then things sped up – with negotiators even agreeing to meet on a Saturday for the first time in 17 years – and farm bill implications were bullish again, further explaining the recent strength in soybean prices.

On the international front we find another factor driving the market. The Argentinean government has threatened to impose a 23.5% tax on exports that would be enforced retroactively. Last Wednesday the tax was on. Thursday it was off. Friday it was on again. You get the picture. At the end of the day, the tax will not change the size of the Argentinean crop, which – sooner or later, one way or the other – will be shipped. In the interim, the logjam is sending buyers north to the US, which is certainly a short-term bullish factor. We should point out that the threat of supply interruptions was bullish for US wheat prices for a while a few months ago. Once the story moved out of the news, however, wheat prices collapsed.

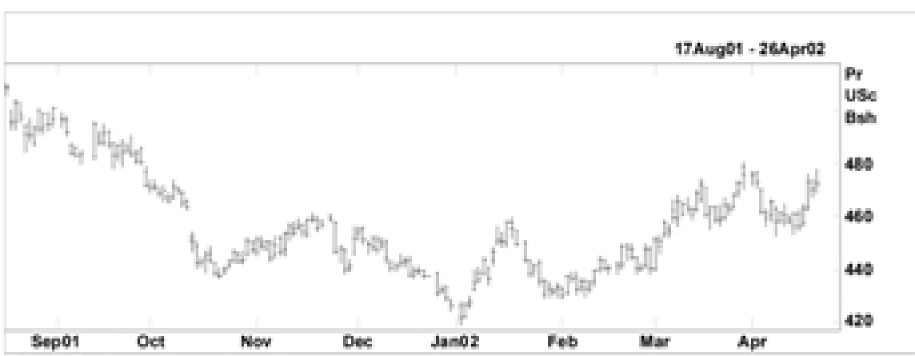
The most bearish item contained in this month's USDA report was also from South America. Argentinean production was raised by 750,000 tonnes, to 28.5 million tonnes. Actually, that wasn't much of a surprise. Brazilian output was held at 43.5 million tonnes and that was probably more bearish than the Argentinean increase, because many analysts were looking for a reduction in Brazilian production to about 41.5 million tonnes.

Statistically speaking, the fundamentals of the soybean market have certainly taken somewhat of a bearish turn, with global ending stocks being raised 630,000 tonnes over last month, to 29.43 million tonnes, or 15.9% of consumption (15.59% last month). It is difficult to imagine that the influx of South American supplies is not going to put pressure on prices at some point. On the other hand the surprising improvement in US exports, as illustrated, balances the negative supply side.

We stepped away from our long position a bit prematurely. Nevertheless, we still believe that the declaration contained in the title of our last article on soybeans: "The bear market is over," is accurate. For now, however, we watch from the sidelines. *[April 22, 2002]*

STRATEGY: *Remain sidelined.*

Chart 1 – May Soybeans



Courtesy Reuters

COCOA

Can cocoa grind data be telling the whole story?

The demand side of the cocoa market has not participated in this bull market. Or so it would seem from grind statistics. First-quarter grinding figures are now in from the three principal grinding regions, and they all paint a dismal picture. The German grind fell 15.75%, to 47,897 tonnes, the US grind was 13.8% lower at 98,005 tonnes, and the pan-European grind was 16.6% lower at 153,811 tonnes.

Aside from being significantly below analysts' expectations, there wasn't much shock value in these numbers. E.D.&F. Man has been saying all along that poor processing margins would keep grindings low. There are other factors, however, that seem to indicate that demand is actually better than the grind figures show.

Accompanying the US grind statistics are the liquor and butter melt numbers, which represent imports of solids that are melted in the US. The liquor melt was up 168% over first quarter last year, and the butter melt was 7.92% higher. Although their bean equivalents amount to only 13,000 tonnes, when added to the grind, consumption was down only 9.28% for the US, rather than 13.8% when looking at the grind alone. While the difference is not great, it does illustrate that there exists a series of realities regarding demand for cocoa beans that is not reflected in the headlines. The grind numbers in Europe cover about 75% of grinding activity, and in the US they cover even a greater percentage, but they don't cover all the activity.

Furthermore, we should remember that the grind is merely a proxy for consumer demand for chocolate. In the short run, the amount of beans processed is a function of the profitability of processing margins. Ultimately, the level of consumer demand will work back through the system to determine whether enough beans were ground, imported, and grown. A UK company, Leatherhead Food Research Association, estimates that global chocolate consumption actually grew by 5.8% in 2001 to 5.5 million tonnes. And besides – a point we've made many times – the growth of grinding in origin countries is not properly counted. As a result, it is difficult to know just exactly how many beans are ground globally.

We're taking some liberties with a number of assumptions in the above discussion, but how else can we explain a market that refuses to go down, even when fed a steady diet of bearish news?

The primary issue on the supply side at the moment is the size of the Ivorian mid-crop. In March, an Ivorian marketing board released an estimate that put the mid-crop at between 240,000 and 270,000 tonnes, which would wipe out the projected global production/consumption deficit. This was a rather shocking piece of news, because most Western analysts were talking about a mid-crop of between 100,000 and 150,000 tonnes. Although the Ivorian estimate was probably nowhere near realistic, it acted as a catalyst for a selloff that took the market down about $100 per tonne. The market has bounced back, registering new contract highs, without the benefit of any obviously bullish developments (other than the invisible fundamentals that we described above).

The market awaits E.D.&F. Man's next report, to be released any day now. Although it is still quite early in the mid-crop season, which runs from April through September, it will be very informative to see if Man changes its previous forecast of something over 100,000 tonnes. With the most recent tally of Ivorian main-crop arrivals sitting at 1.03 million tonnes, the total crop would still be close to 100,000 tonnes shy of Man's last forecast of 1.22 million tonnes. Assuming there were no major changes in other regions, this would push the global production/consumption deficit back over 200,000 tonnes from Man's February estimate of 136,000 tonnes.

A final note: The persistent backwardation and the composition of the open interest serve as evidence that the source of the market's strength is commercial demand and not speculative. The 1-year spread (July 2002/July 2003) sits at an eye-popping $185 per tonne (Chart 2). As of the most recent Commitment of Traders report (COT), commodity funds have slipped into net-short position territory, and the net-long position of small speculators has fallen to 2,948 contracts compared with a long position of 4,896 contracts in early February, when the market was about $150 per tonne lower (Chart 3).

Open interest has been building since the last COT report, so the composition may look different after the next report, which could be some cause for concern and which we are monitoring carefully. In the meantime – with the prices perched right near the peak of multi-year highs – we remain long and look for yet another series of fresh contract highs. *[April 25, 2002]*

STRATEGY: *Remain long July cocoa as per Flash Update of April 17. Maintain initial stops at 13.80, close only.*

Chart 2 – July 2002/July 2003 cocoa spread

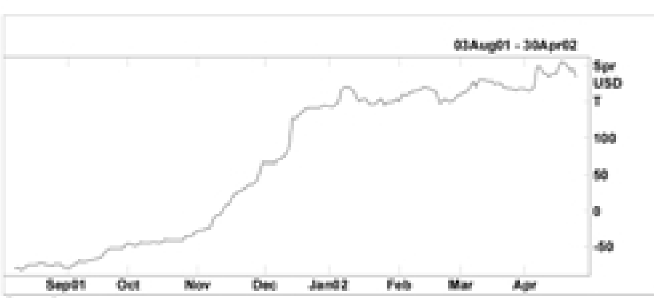
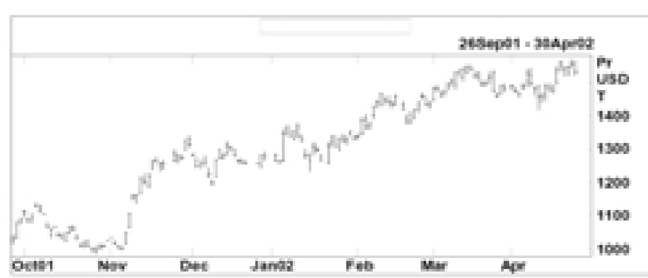


Chart 3 – July cocoa



GOLD

The bull builds a head of steam

Gold prices are enjoying their most sustained rally since the mid-1990s, when they peaked at just over $400 per ounce (Chart 4). The rally in 1999 was larger than the current move – from $255 to $338 per ounce – but it was a spike that lasted for about a month. The current rally is over a year old and seems to stand on more solid ground.

The fundamentals continue to develop in the same direction that they have been since we began to move off the bottom in February 2001. In fact, Gold Fields Mineral Services (GFMS) latest report, released yesterday, shows both the bullish and bearish issues continuing to grow in their respective directions.

The "commodity angle" fundamentals – mine production and fabrication – are both negative. Mine production rose by 20 tonnes, to 2,604 tonnes in 2001, and output is expected to increase again this year by a further 18 tonnes, or 0.7%. This is not an overwhelming amount, but is a disappointment in an environment in which analysts had expected production to taper off after years of falling bullion prices. Cash costs have been falling, which has allowed mining companies to remain profitable.

A breakdown of the various gold mining regions show that, indeed, high-cost producing countries have seen production slip and lower-cost producers have seen an increase in output. South African production has fallen below 400 tonnes for the first time in 48 years. US and Australian mines produced 6% and 4% less, respectively. On the other hand, other countries have picked up the slack. Low-cost Indonesian mining has seen production grow by 31%.

On the demand side, GFMS reports that weak economies around the globe pushed fabrication to a five-year low. Global jewelry demand fell 5%, while industrial demand fell 14%.

The gold market, however, has dynamics different from other commodities. The hedge market put pressure on gold prices throughout the bear market. High interest rates kept an attractive contango in place for years, which made the forwards attractive for locking in prices. But rates are low, and it seems that they are not about to rise any time soon. This is especially true after Fed chairman Alan Greenspan – in comments made last week – indicated that the economy is not yet ready for a change in monetary policy. We observed (see *Focus on Futures*, April 22, "The US dollar has rolled over"), "In his latest policy remarks, he indicated a strong wish to be very patient in moving away from an accommodative stance."

Many mining companies have stated publicly that they have moved to a no-hedge policy, and this is reflected in GFMS's numbers. It estimates that net-hedging in 2001 fell for a second consecutive year, creating 147 tonnes of demand.

Central bank selling rose by 15 million tonnes in 2001, but has ceased to be the same overhang it was before the Washington agreement, which limited European sales to 400 tonnes per year.

Back in February, Bundesbank president Ernest Welteke caused a stir when he told a reporter that Germany would consider selling off some of its gold holdings, estimated to be as large as 3,500 tonnes. This could destabilize the Washington agreement if Germany jockeys aggressively to rework the agreement to facilitate the sale of its massive inventories. For now, though, official sector sales are no longer the psychological drag on the market that they were during the 1996-2000 leg of the bear market.

Referring again to *Focus on Futures* of April 22 ("The US dollar has rolled over"), a whole new dimension has been added to the gold market. The dollar has been in a powerful bull market which has decimated the price of many dollar-denominated commodities by making them too expensive abroad. If our call for the end of dollar strength is accurate, demand for gold will surely be a beneficiary.

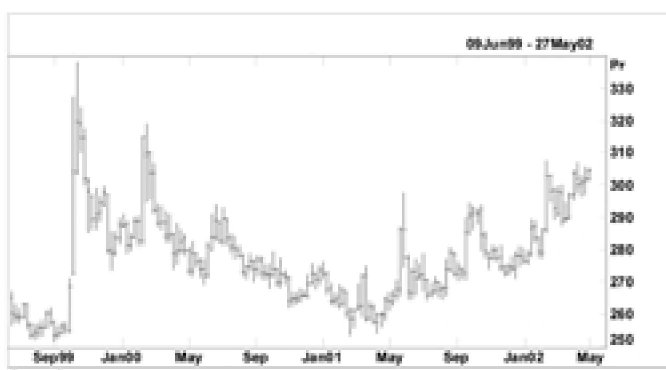
Finally, while difficult to gauge, we believe that investment demand for gold has surfaced. The stock market has become an unfriendly place, and even a small shift in portfolio allocation towards gold will create a significant amount of demand.

In conclusion, the negative implications of stable production and soft fabrication demand are affecting this market. But the absence of selling pressure from mining hedges seems to be a far more formidable force. Mining companies and investors are bullish, a sure-fire combination for a bull market.

We continue to recommend holding moderate sized, sustainable long positions. *[April 25, 2002]*

STRATEGY: *Remain long June gold. Maintain stops at 260, close only.*

Chart 4 – Spot gold



COPPER

Is this rally for real?

Over the past six months copper prices have enjoyed a powerful, 15¢ per pound rally off unsightly lows of close to 60¢ per pound. In its most recent report, the International Copper Study Group (ICSG) estimated that 2001 ended with a global surplus of refined copper of 687,000 tonnes. It is a fairly burdensome carryover when compared with the 478,00- tonne deficit at the end of 2000. It surpasses the surpluses at the end of 1997 and 1998 of 402,000 tonnes and 611,000 tonnes, respectively.

ICSG's outlook, however, is brighter. It forecasts that the surplus will be wiped out by the end of 2002. Production should fall by 280,000 tonnes, to 15.16 million tonnes, while consumption should increase by 437,000 tonnes, to 15.18 million tonnes.

Two important bullish events are responsible for the potential turnaround: the economic recovery and producer cutbacks. Friday's release of US first-quarter GDP data confirmed that the bull run we've been watching was tied – at least in part – to robust economic activity. The Commerce Department estimated that the economy grew at an annualized rate of 5.8%. That was a full percentage point higher than expectations and the strongest quarter of growth since the fourth quarter of 1999. This and the announcement by a number of large mining companies late last year that they would cut back production by over 500,000 tonnes per year combined to underpin the rally. Armed with these two developments from both the supply and demand sides, traders bid up copper prices. Are these two fundamentals sustainable?

Bulls have a lot to deal with at this juncture.

Bulging warehouses at the LME (970,000 tonnes) Shanghai (246,000 tonnes), and COMEX (321,000 tonnes) are becoming increasingly difficult for bulls to explain away. Inventories at all three exchanges have more than doubled over the past year and sit at record highs. Although it is hard to know how much of those stocks are actually available, the amounts are staggering.

While the economic data we've seen are a clear indication that we were in an environment that was friendly to demand for industrial commodities, it does not tell us much about the future. Economists, naturally, are divided. But many well-regarded analysts are less optimistic now then they were a couple of months ago about the economy's ability to maintain the momentum we had in the first quarter.

As well, we cannot be certain that producers will honor all the proposed production cuts after achieving their initial goal of talking the market back up to prices that are above the cost of production. In a conference call with shareholders last week, Phelps Dodge, the world's second largest producer of copper assured investors that an output curtailment program was in place.

With average cash production costs falling around the globe, however, it will be a challenge for producers to resist mining as much copper as they can so long as they remain profitable.

Phelps Dodge, with mines in high production-cost regions, has indeed curtailed production at those mines. Along with its first quarter results, Phelps Dodge reported that production dropped from 294,000 tonnes in the first quarter 2001 to 257,000 tonnes this year. There is speculation, however, that as prices stabilize and costs remain low, output will be increased at lower-cost facilities. During the same period, cash costs fell to 53¢ per pound, 12¢ per pound less than first quarter 2001. Freeport McMoran reported net cash production costs in the first quarter of 29¢ per pound. With copper at 70¢ per pound – and even lower – copper mining can still a very attractive business.

That's the bearish case. At the moment, the most likely scenario is that prices will remain confined to this range. On the consumption side, strong economic fundamentals are required to generate enough demand to make prices move higher, and the outlook for these fundamentals are unclear. On the supply side, it does seem – by and large – that mining companies have abided by their proposed cutbacks thus far. It is difficult to know whether they will continue to do so.

We correctly anticipated that the economic recovery and output cutbacks would keep this market strong for a while. True, we were never bullish enough to profit from trading the long side, but we kept out of trouble. We continue to believe that the market's resilience in the face of inexplicable mountains of inventories means that this market is not quite ready to fold up and return to the 60¢-per-pound level. The rally will achieve more credibility if evidence begins to surface that we will have stronger than anticipated economies in the US and abroad. If this is not the case, we will have a keen interest in the short side. *[April 29, 2002]*

STRATEGY: *Remain sidelined.*

HOTLINE UPDATE

***Flash Update* – Monday, March 25, 2002:**
Good morning for Monday, March 25, 11:10 am. This is a Flash Update. We have rolled over our April gold positions into June.

Thursday, March 28, 2002:
Good afternoon for Thursday, March 28, 4:45 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long June gold, with our stop at 260; long September cocoa, with our stop at 1375; long May soybeans with our stop at 450; long May wheat, with our stop at 270; and short June mini S&P with our stop at 1180. All stops are close only.

Friday, April 5, 2002:
Good afternoon for Friday, April 5, 4:45 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long June gold, with our stop at 260; long September cocoa, with our stop revised to 1425; long May soybeans with our stop at 450; long May wheat, with our stop at 270; and short June mini S&P, with our stop at 1180. All stops are close only.

***Flash Update* – Wednesday, April 10, 2002:**
Good morning for Wednesday, April 10, 10:45 am. This is a Flash Update. We have liquidated our long May wheat position at 270 1/4.

***Flash Update* – Wednesday, April 10, 2002:**
Good morning for Wednesday, April 10, 10:45 am. This is a Flash Update. We have liquidated our long September cocoa position at 1410. We repeat our Flash Update of earlier this morning where we liquidated our long May wheat position at 270 1/4.

***Flash Update* – Friday, April 12, 2002:**
Good afternoon for Friday, April 12, 2:25 pm. This is a Flash Update. We have liquidated our long May soybean position at 461 1/4.

Friday, April 12, 2002:
Good afternoon for Friday, April 12, 4:55 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long June gold, with our stop at 260 and short June mini S&P with our stop revised to 1135. All stops are close only.

***Flash Update* – Wednesday, April 17, 2002:**
Good afternoon for Wednesday, April 17, 1:45 pm. This is a Flash Update. We have purchased July cocoa at 1547, placing our initial stop at 1380, close only.

Friday, April 19, 2002:
Good afternoon for Friday, April 19, 4:55 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long June gold, with our stop at 260; short June mini S&P, with our stop at 1135; and long July cocoa, with our initial stop at 1380. All stops are close only.

Friday, April 26, 2002:
Good afternoon for Friday, April 26, 4:25 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long June gold, with our stop at 260; short June mini S&P, with our stop at 1135; and long July cocoa with our stop at 1380. All stops are close only.

Subscription Enquiries for
Friedberg's Focus on Futures
P.O. Box 866, Suite 250
BCE Place, 181 Bay Street
Toronto, Ontario, Canada
M5J 2T3
(416) 364-1171

All enquiries concerning trading accounts should be directed to:

In Canada
Friedberg Mercantile Group
P.O. Box 866, Suite 250
BCE Place, 181 Bay Street
Toronto, Ontario M5J 2T3
(416) 350-2903
Attn: Sholom Sanik

In U.S.
Friedberg Mercantile Group Inc.
67 Wall St., Suite 1910
New York, N.Y. 10005
(212) 943-5300