

# FRIEDBERG'S

## FOCUS ON FUTURES

Friedberg Mercantile Group Ltd.



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## Can global wheat production make it two in a row?

Wheat prices rallied 75¢ per bushel between mid-February and mid-March. The strength was more related to developments in the soybean market than it was to changes in the supply/demand fundamentals of wheat. While soybeans had good reason to rally (bad weather in Brazil and uncertainty about US planting intentions), wheat and corn (which also participated) had only short covering of a burdensome fund short position to explain their rally. Indeed, wheat and corn prices have fallen back to within a chip-shot of their early-February lows, whereas soybeans have retained the bulk of their gains (Chart 1).

Now that the rally has been washed out, the speculative long position that developed during the rally has been reduced, and the market seems to have found some support, where do we go from here?

Most recent developments have been bearish, but seem to have been absorbed by the market and have not caused any further selling. The March 31 USDA planting intentions report showed spring wheat acreage at 14.37 million acres, above both last year's 13.76 million acres and analyst estimates of 13.73 million acres. Using a yield of 40.8 bushels per acre, the average yield of the past three years, this represents an increase of 713,000 million tonnes between expectations and the actual number. That may be a lot when expressed as a percentage of the spring wheat crop, which comprises only 25% of the total US crop, but in terms of the global picture it doesn't mean very much.

The bulk of the US crop, though, is in fine shape. The first weekly crop progress report for winter wheat showed that 68% of the crop is in good-to-excellent condition. This was followed by an uptick the following week to 70%, which exceeds last year's first look, when the good-to-excellent portion of the crop was only 48%. Although this year's early acreage estimate was 1.74 million acres less than last year's, yields are likely to be higher.

Demand for US wheat was generally expected to be sluggish because of the large crops grown in most regions around the globe. Earlier in the marketing year, the estimate for 2004-05 US exports were for sales of about 26 million tonnes, sharply lower than 2003-04 sales of 31.56 million

tonnes. But a fairly steady flow of weekly commitments has pushed this figure up. In the April supply/demand situation report, the USDA once again raised its estimate by 680,000 tonnes to 28.58 million tonnes.

Commitments for the season stand at 26 million tonnes, leaving 2.6 million tonnes to be sold by the end of May, or an average of just over 300,000 tonnes per week. Most sales have still been for old-crop, which makes the target attainable, but not a shoo-in.

Looking ahead, Northern Hemisphere winter wheat crops are heading into harvest in just a couple of months. An early forecast by the International Grain Council (IGC) is calling for a smaller global crop for the 2005-06 marketing year of 601 million tonnes, down from 623.77 million tonnes in 2004-05. Last season's bumper crops ended a six-year string of declining global production and the resulting production/consumption deficits. A return to a deficit market that could begin another era of stock drawdowns should be quieting for bears. ICG estimates a small increase in demand, to 610 million tonnes, which would draw down ending stocks by 9 million tonnes.

In itself, this would not make for a meaningful change.

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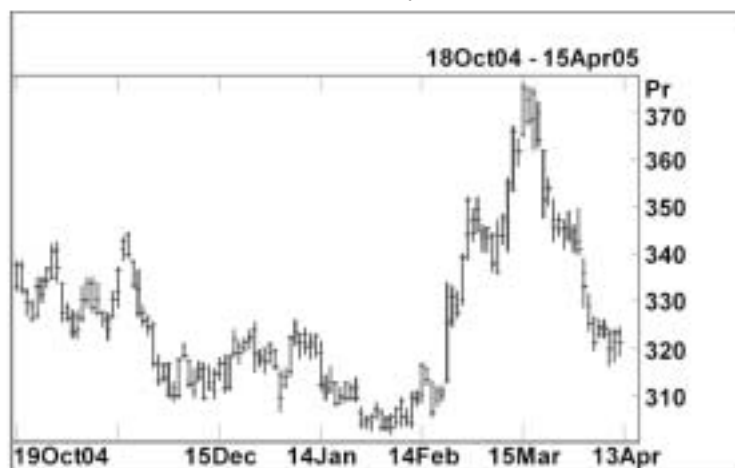
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Carryover stocks as a percentage of consumption would fall by about 1 percentage point, to 23% of usage. If, however, rather than following the pattern of most other agricultural commodi-

ties whose output is in a perpetual uptrend, the bountiful wheat crops harvested in 2004-05 turn out to be an anomaly, we could see inventories tighten back to critical levels. [April 12, 2005]

Chart 1 – July wheat



Courtesy Reuters

## COTTON

### Burdensome inventories poised for a drawdown

Cotton prices have set back after a sharp 11¢-per-pound rally ran out of steam at the end of March. Prices have since consolidated, maintaining the uptrend intact (Chart 2). The market's strength was the result of a number of bullish developments on both the supply and demand sides.

As we discussed in the February 25 issue of *Focus on Futures*, 2004-05 US exports were expected to fall from the record levels we saw in 2003-04. China would need to buy substantially less cotton from the US during the 2004-05 marketing year because of its huge 29-million-bale crop (22.3 million bales in 2003-04). As of this past week's export commitment report, China had contracted to buy only 1.9 million bales from US exporters, compared with 4.6 million bales at this time last year. Nevertheless, total US exports have surprised to the upside. The USDA is now forecasting annual sales of 13.2 million bales, only 500,000 bales below last year's final tally and close to 2 million bales above early season estimates. Commitment data show that we are running very close to achieving the USDA target.

Further on the demand side and looking ahead, in late February, at its Annual Outlook Conference, the USDA forecasted that Chinese imports would increase significantly in the new marketing year to 14.5 million bales, compared with 2004-05 imports of 8 million bales. This would be partly attributable to decreased acreage in China (more on that later) and an increase in consumption, to 41.2 million bales, compared with 2004-05 consumption of 37.5 million bales. Naturally, the accuracy of these bold estimates will

depend on variables such as the performance of the domestic and international economies. In any case, these predictions do explain in part the strong rally.

Then, on March 7, a USDA attaché report forecast that 2005-06 Chinese acreage would plummet by 17%. Assuming steady yields, this would mean that Chinese output would drop by some 5 million bales, to 24 million bales. The main reason for the anticipated decline in acreage is that the domestic cotton/grain price ratio favors grain planting.

For the US, the March 31 planting intentions report showed acreage at 13.82 million acres, above last year's 13.66 million acres but below the average street guesstimate of 13.99 million acres. This doesn't necessarily mean that we're going to see a bigger crop. In its April supply/demand situation report, the USDA once again raised its estimate for 2004-05 yields to 848 pounds per acre, a record by far. As we detailed in the February 25 issue of *Focus on Futures*, however, it would be an anomaly for yields to increase again in the 2005-06 season.

As we near the end of the 2004-05 season, global ending stocks stand at 47.83 million bales, or a very bear-marketish 44.7% of consumption. The May USDA supply/demand situation report will include the first glance at the 2005-06 season. At this point, that forecast will be making many assumptions like those we highlighted above.

Even if we were to make some conservative projections, such as reducing Chinese output by only 3 million bales and increasing global demand by 3 million bales, the global ending stocks picture would shift significantly. In

2002-03 and 2003-04, ending stocks were 38.7% and 36% of consumption respectively. Those inventory levels were low enough to drive prices from 30¢ to 85¢ per pound in November 2003. If the forecasts for 2005-06 Chinese supply and demand are even near accurate, we will be looking at a global production/consumption deficit that will draw ending stocks down below 40% of consumption.

For now, it seems that the record crops in the US and China in 2004-05 were a one-time event. If demand does not disappoint, prices should work their way higher. We do not expect the market to retreat anywhere close to the 42¢-per-pound lows we saw late last year. Any reasonable dip that tests the 49¢-per-pound level should be considered a buying opportunity. *[April 19, 2005]*

Chart 2 – July cotton



*Courtesy Reuters*

## **COPPER**

### **Some mixed signals and a resilient bull, but it won't last forever**

On March 29, the bearish case for copper took a bit of a detour. The Chilean government reported that output for February was down 5% over February 2004. This followed an 11.9% increase for January production. The torrid pace of Chilean production – as well as output of other producing nations such as Indonesia and the US – has been the principal supply-side factor cited by bearish analysts who believe that the \$1.50-per-pound level is unsustainable. For most of 2004, Chilean output was growing at a rate of over 10% per month. There is little indication, however, that the poor performance in February was the result of anything more than temporary glitches at mining facilities.

Copper prices proceeded to new contract highs in the days following this report. However, on April 12, after May copper briefly traded at \$1.5360 per pound, the market turned lower and set up what technicians call a “key reversal,” with the market tumbling by 12.5¢-per-pound, or a stiff 8%, over the next three sessions. The selloff cleared the bottom of a two-month trading range. The market has since rallied.

However nervous the dip in Chilean output may have made bears, a report released on April 13 by the Chinese government concerning the demand side should be just as chilling for bulls,

or more so, and could prove to be the beginning of a longer term trend. The report said that Chinese imports in the first quarter fell by 15.1% over the same period in 2004. China’s economic growth, even if it were to suffer due-course setbacks, was expected to keep its demand for industrial commodities strong. In addition, government infrastructure projects were believed to be at least partially immune to broader economic weakness in the private sector. Apparently, current reports from industry sources indicating that prices were too high for China to continue its 2004 purchasing patterns were accurate.

Economic data in the US, the EU, and Japan released over the past several months have mostly been on the weak side. Economists have been inching down their forecasts for US 2005 GDP. It is difficult to make an argument for consumption to repeat the performance we saw in 2004.

According to The International Copper Study Group (ICSG) data, total global output for 2004 was 15.78 million tonnes, 3.6% higher than 2003. Usage was 16.49 million tonnes, up 5.54% over 2003, which left a deficit of 706,000 tonnes. For 2005, ICSG is forecasting that output will grow 8.5%, to 17.1 million tonnes, and that demand will increase by 5.3%, to 17.4 million tonnes, leaving a deficit of 259,000

(numbers don't add up exactly due to rounding).

Based on recent mine production trends, we're okay with the output estimates for 2005. With the economies in the major financial centers showing weak data, however, and the outlook for the balance of the year not much brighter, it is somewhat of a stretch to assume that consumption of this economy-sensitive commodity will continue to grow at the same rate as it did in 2004, when economic activity was considerably stronger. The sharp drop in Chinese imports mentioned above may just be the tip of the iceberg.

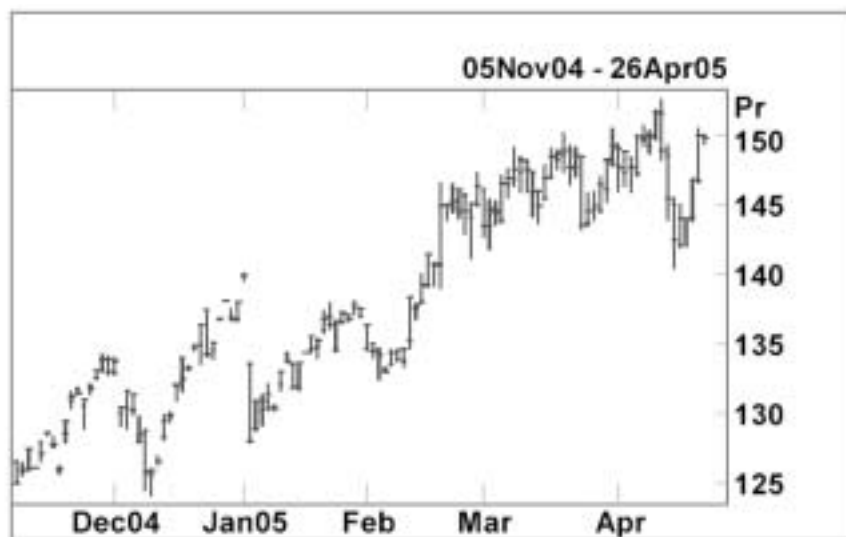
For now, recent history is repeating itself. Commodity

funds were right back in, buying the dips. Although the funds have reduced their net-long position by some 10,000 contracts, they still remain net-long 28,000 contracts as of this past Friday's Commitment of Trader's report. With prices almost back to the high of the trading range, it is quite reasonable to assume that this week's commitment data will show that the funds have once again re-established the longs they liquidated during the market's selloff.

We're confident that supply/demand fundamentals are not being fairly represented at these lofty price levels.

[April 21, 2005]

Chart 3 – July copper



Courtesy Reuters

## CORN

# Bearish fundamentals on paper, but outlook brighter

The popular bullish consensus services list corn as having the lowest or near-lowest reading among all commodities. The negative sentiment is well warranted. Few, if any, commodities are trading near multi-year lows (Chart 4). Even after a chunky correction in the CRB (Chart 5) and other commodity indexes, most commodities have maintained the lion's share of their price gains achieved over the past two years.

Indeed, supplies are burdensome as we head towards the end of the 2004-05 marketing year. The USDA raised its estimate for global ending stocks in the April supply/demand situation report to 124.68 million tonnes, or 18.36% of consumption, up from the March estimate of 122.04 million tonnes, or 17.9% of usage. This compares with 2003-04 ending stocks of 15.1% of consumption.

The March 31 quarterly stocks report showed US inventories at 171.41 million tonnes, above street guesstimates of

170.6 million tonnes and compared with 134 million tonnes at the same time last year.

Finding anything bullish to say about corn is quite the challenge – at least from a statistical point of view.

The pace of US export commitments has been steady, but not strong enough to keep the USDA from lowering its estimate for annual sales to 45.72 million tonnes from the March estimate of 47 million tonnes. At 35.6 million tonnes, commitments to date are lagging last year's pace. There is ample time remaining to sell old-crop corn before the end of the marketing year. With 19 weeks left, sales would have to average just over 500,000 tonnes per week to reach the USDA target, not an overwhelming amount, assuming it happens sooner rather later, before new-crop sales take over. The recent alerts issued by Japan and the EU regarding diseases found in US corn could put a damper on the prospects, though.

The only bright spot in recently released statistics was the March 31 planting intentions report. US farmers will seed 81.41 million acres. Although this will be a larger area than last year's 80.93 million acres, analysts overestimated the rust-fear-induced soybean to corn shift. The average street guesstimate was looking for close to a million acres more than the actual number.

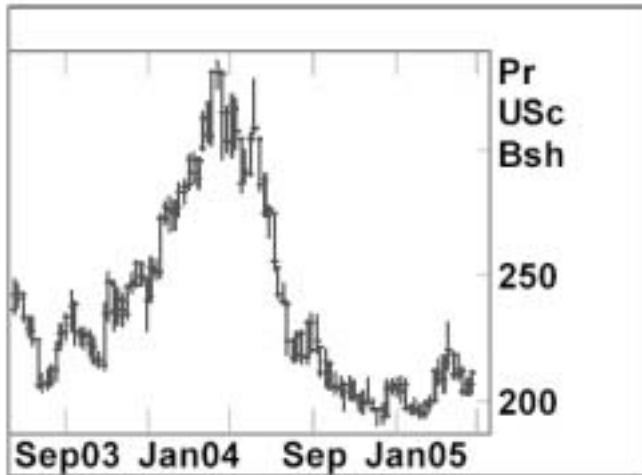
The picture painted by technical analysts, and by the fundamentals, is bearish and has attracted enough bears to keep sentiment weak and commodity funds in a net-short position. But, we believe that these low prices are actually setting up a more bullish outlook.

Leaving the soybean rust issue aside – after all, intentions were higher than expected for soybeans and lower for corn –

it is far more profitable for farmers to plant beans than it is to plant corn. Chart 6 shows that November beans have been rising steadily *vis-à-vis* December corn, which makes locking in prices for soybeans a better deal for any farmer who is still in a position to decide between the two.

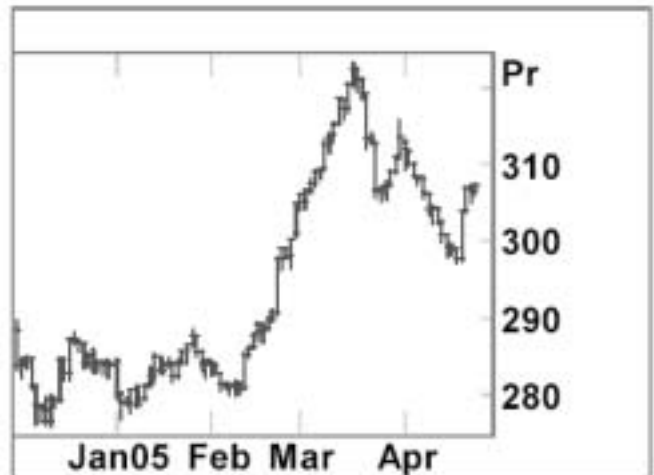
In the February 17 issue of *Focus on Futures* we argued that it is highly unlikely for record 2004-05 US yields of 160.4 bushels per acre to be repeated. Those yields were 13% higher than the previous season. It is therefore very early in the season for corn to be trading near the low of the range with the bulk of the planting season and all of the growing season ahead of us. Last year's crop coasted through perfect conditions for the planting, growing, and harvest periods. We reiterate a low-risk buying opportunity. *[April 22, 2005]*

Chart 4 – Nearest contract corn



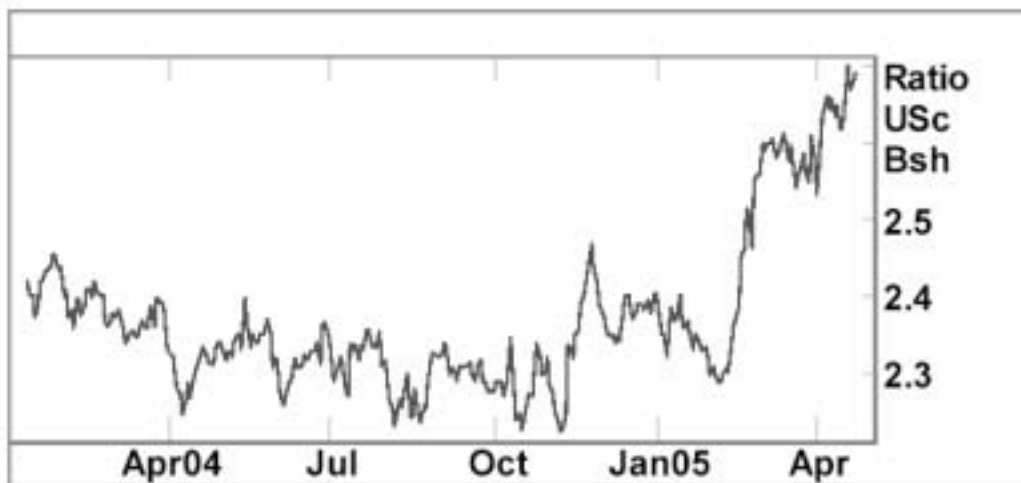
Courtesy Reuters

Chart 5 – CRB Index



Courtesy Reuters

Chart 6 – November soybeans/December corn



Courtesy Reuters

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## **HOTLINE UPDATE**

**Friday, April 8, 2005:**

Good afternoon for Friday, April 8, 5:00 pm. We are currently holding no positions.

**Friday, April 15, 2005:**

Good afternoon for Friday, April 15, 4:30 pm. We are currently holding no positions.

**Friday, April 22, 2005:**

Good afternoon for Friday, April 22, 4:25 pm. We are currently holding no positions.

**Friday, April 29, 2005:**

Good afternoon for Friday, April 29, 4:45 pm. We are currently holding no positions.

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