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The world is running out of corn

The mid-March slide in corn prices was triggered by the earthquake in Japan. Most commodity prices fell while traders grappled with the economic implications of the disaster, and specifically, how it would affect demand for food and raw materials.

There were other corn-related issues to worry about, though. The quarterly stock report has proven to be a market mover over the past couple of years, and there were many different opinions as to how the March 31 report would look. While yield-per-acre was poor for the 2010-11 US corn crop, quality was favorable, which means that ethanol producers achieved higher yields per bushel of corn. If this is accurate, it would mean that the USDA's estimate for ethanol production in corn-equivalent terms is too high. Others believed that meat prices were sufficiently strong and that feed lot operators would remain profitable even with historically high grain prices, which would result in greater-than-expected disappearance.

This and other debates were resolved with a resoundingly bullish report. The quarterly stock report data showed that corn stocks in all positions as of March 1 were 6.522 billion bushels (165 million tonnes), down sharply from last year's first quarter level of 7.694 billion bushels (195 million tonnes). More importantly, it showed that analysts were off by a wide margin. The average guesstimate was 6.69 billion bushels (170 million tonnes). That would draw 2010-11 US ending stocks down to an unbelievable record low of 507 million bushels (12.9 million tonnes), or about 3.5% of consumption.

The first planting intentions report is released concurrently with the March inventory report and is also watched closely for clues to what lies ahead in the 2011-12 marketing year. With high corn prices and growing demand, it was widely anticipated that US farmers would ramp up corn area from last year's planted acreage of 88.192 million acres. The average analyst guesstimate was 91.839 million acres, but the actual figure came in at 92.178. As indicated above, the 2010-11 bushel-per-acre yield of 152.8 was significantly lower than the previous season's 164.7 bpa. To calculate output to be added to the balance sheet as a result of the higher-than-expected area, we assumed that 2011-12 yields will stabilize and increase to 157.13 bushels per acre – the average of the past three seasons. The difference in output between the guesstimate and the actual figure will be 53 million bushels (1.3 million tonnes), which is dwarfed by the corn we lost in the quarterly stocks report. The net result of the two reports was clearly bullish.

To complicate the already tight world carryover situation, China has again emerged as a potential corn importer. Last summer, China spooked the market when it made its first foreign purchases of corn in years. This past week, old-crop US export commitments were an extraordinary 1.9 million tonnes. It was in the range of expectations, so it was not a shock. It was a bit strange, though, because the largest single sale of 1.2 million tonnes was not attributed to any country but rather to an "unknown" destination. It is widely believed that China is the ultimate destination for the large purchase.

US export commitments to date total 38.3 million tonnes, 11% ahead of last year at this time. The USDA target for 2010-11 exports is 49.5 million tonnes, only 6.6% ahead of last year.

If we incorporate the quarterly stock report and slash over 4 million tonnes from the global balance sheet, ending stocks would fall to 14% of consumption. We'd have to go back to the early 1970s to find such low inventories.

New-crop corn prices are heavily discounted to cash in anticipation that new crops harvested this fall will alleviate the tightness. We believe that we are in a long-term bull market. The corn and sugar markets are unique among agricul-

Inside

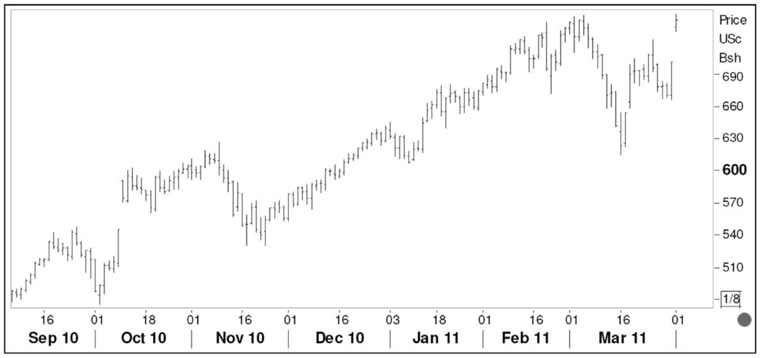
Unless otherwise indicated, all articles have been written by Sholom Sanik (E-mail: *ssanik@friedberg.ca*).

tural markets in that they must allocate a growing share of their crops to the biofuel markets. For corn, it is painfully obvious that we have not achieved efficiency in this regard. The US is the world's supplier of last resort, and within a few months it will run out of corn.

Remain long old-crop contract months and establish new long positions in new-crop December.

[April 1, 2011]

Chart 1 – July corn



Courtesy Reuters

Chart 2 – July/December corn spread

Courtesy Reuters

WHEAT

Acres galore, but shortages of food-quality crops still possible

The March 31 USDA reports were bullish for all US agricultural markets – with the exception of wheat. There were three reports for wheat: 2011-12 winter-wheat acreage revisions; planting intentions for the 2011-12 spring wheat crop; and quarterly stocks. All the reports should have been negative for prices, but old-and new-crop contracts are both trading about 50¢ per bushel above where the market closed on the evening preceding the release of the report (Chart 3). Why?

The 2011-12 winter wheat crop was planted last fall and will soon be harvested. In January, the USDA estimated that the crop was planted on 40.943 million acres. Analysts were expecting the USDA to increase that estimate. The average guesstimate was 41.104 million acres, but the actual figure came in at 41.229 million acres, 125,000 acres higher than the guesstimate.

The bigger surprise, however, was in spring wheat. Spring wheat is planted in the spring and harvested in late summer. Although spring wheat represents less than 30% of the total US crop, the gap between analysts' expectations and the actual figure could have been a market mover. The average guesstimate was 13.728 million acres, but the actual figure was 14.427, close to 700,000 acres more than expected. Durum area was 187,000 acres less than expected, but US durum wheat is used strictly for pasta and has no connection to the market for bread wheat.

Using the average yield and harvested-to-planted ratio of the past three years, we would have to increase early projections for 2011-12 ending stocks by 32.5 million bushels, because of the uptick in the estimate for winter wheat acres and the unexpected spring wheat acres.

Then we had the quarterly stocks report, which showed March 1 wheat inventories at 1.425 billion bushels, 26 million bushels above the average guesstimate.

According to these three reports, available supplies for the 2010-11 and 2011-12 marketing years are 58.5 million bushels, or 1.6 million tonnes, larger than previously believed. In the grand scheme of the global balance sheet, however, ending stocks as a percentage of consumption will not fall by an appreciable amount as a result of these new estimates.

It would be convenient to say that wheat traders were swept up by the whirlwind blowing through the commodity markets and that the rally is unsustainable. The bullish case has not changed, though, and if anything, has intensified with recent developments. With last season's huge losses in FSU crops and Australia seeing much of its high-quality exportable surplus turn to feed grade, excellent crops were an absolute must to avoid shortages.

As farmers across the Northern Hemisphere prepare to harvest their winter wheat crops, weather in the most important wheat growing regions has been friendly for the most part. The exceptions are Western Europe, Northern China, and particularly the US.

The central and southern US Plains have been dry since the winter wheat crop was planted in the fall. As the crop is about to emerge from dormancy, the situation has not improved – it's been dry, and there is still not much rain in the forecast. Rain is an absolute necessity. According to the USDA's first crop condition progress report released on April 4, the crop is in awful shape. Only 37% of the crop is in the good-to-excellent category, compared with 65% at this time last year.

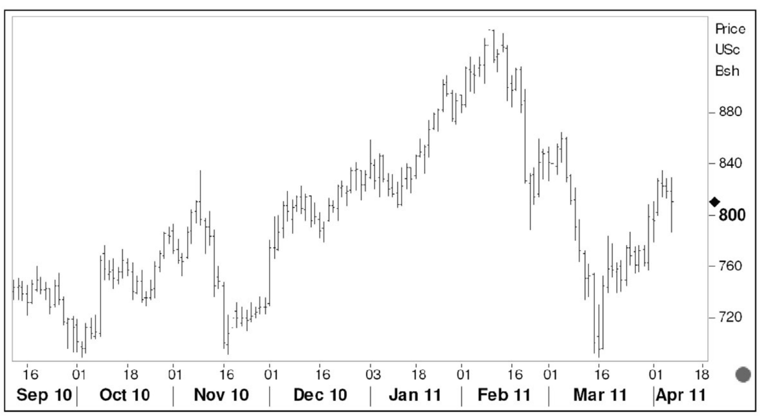
US farmers responded to higher prices by increasing planted area sharply. Total 2011-12 area is estimated at 58.02 million acres, up from 53.6 million acres in 2010-11. The very legitimate fear, however, is that the crop gains will not be anywhere near as large as the increased acreage under current weather conditions.

Furthermore, stocks of feed wheat are ample around the globe, but bread-quality wheat is scarce. Close to 50% of the wheat grown in the US is hard red winter wheat, which is used for making bread. The premium of the Kansas City Board of Trade's hard red winter wheat contract over the Chicago Board of Trade contract has soared to a record high of $1.50, indicating very clearly that a shortage of bread-quality wheat has developed (Chart 4).

Buy July CBOT and/or KCBT wheat.

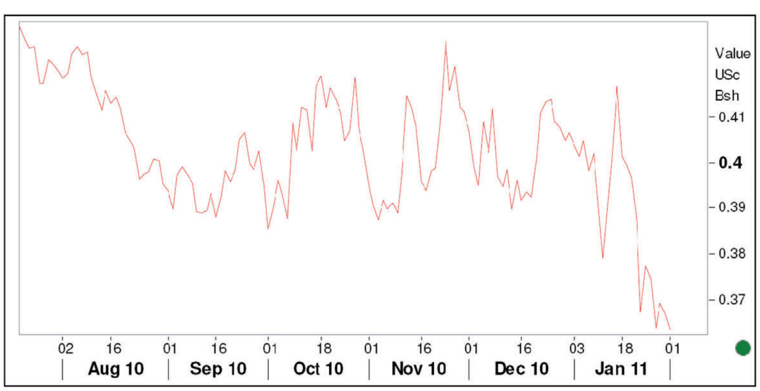
[April 7, 2011]

Chart 3 – July wheat



Courtesy Reuters

Chart 4 – Nearest contract spread KCBT/CBOT wheat



Courtesy Reuters

SOYBEANS

Markets shrug off very bullish old-crop and new-crop reports

Preliminary USDA estimates released in February pointed towards record US soybean plantings of 78 million acres for the 2011-12 US crop. Over the past couple of months, however, analysts have been whittling those estimates down. New-crop prices have favored corn planting since those early forecasts (Chart 5 and 6). Although, the US balance sheet is as tight historically for soybeans as is it is for corn, corn took more acres than expected at the expense of soybeans, because at the global level there is no comparison.

So when the March 31 acreage report showed smaller-than-expected soy acres, it certainly did not come as a shock, but it was still somewhat surprising that at these prices soy farmers were not more enthusiastic. The average analysts' guesstimate was 76.87 million acres, but the actual figure came in at 76.609 million acres, which is down from 77.4 million acres in 2010-11. Assuming 2011-12 yields will reach the average of the past three years, that would translate into about 11 million bushels fewer beans than previously anticipated.

The quarterly stocks report also produced a surprise. The domestic crush is down from last year and back to the recessionary levels we saw in 2008-09. And while exports are running way ahead of last year's pace, foreign sales have tapered off since February. Still, March 1 inventories in all positions were 1.249 billion bushels, down from analysts' expectations for 1.299 billion bushels.

As a result of these two reports, ending stocks for 2011-12 will be trimmed by roughly 60 million bushels. Unlike corn, however, the US is not the supplier of last resort for soybeans. Brazil and Argentina are now harvesting their crops.

Argentinean production will fall substantially below last year's level. Acreage was smaller than last year, particularly for soybeans that are double-planted with wheat, because the wheat harvest finished later than normal. The crop was further reduced after being plagued by drought. Early season estimates put the crop at 52 million tonnes, down 2.5 million tonnes from 2009-10. As the drought intensified, however, estimates tumbled all season long. The current estimate has fallen to 49.50 million tonnes – five million tonnes, or close to 10% below 2009-10 output.

Brazilian production will compensate partially. In the fall, during the planting season, Brazilian output was expected to reach only 67.5 million tonnes, but excellent growing conditions maximized yields. In the April USDA crop report, the estimate for output was revised up, by two million tonnes, to a record 72 million tonnes, and three million tonnes higher than 2009-10.

Global production for 2010-11 was almost the same as the previous season, growing by only 750,000 tonnes. Consumption forecasts, however, jumped by 18 million tonnes, based largely on the anticipation that Asian imports from the US and South America will continue to grow unabated.

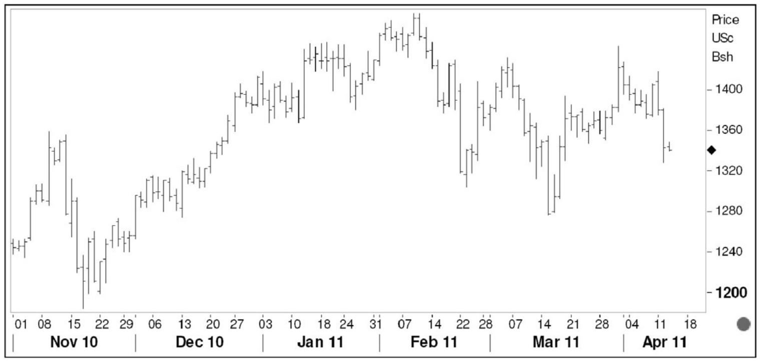
As mentioned above, the Asian appetite for beans may not have been insatiable. US exports have tapered off, but that is seasonable, as purchases start shifting to South America origins. The real problem is that the volumes may be contracting in general. An official with a Chinese state-owned trading house released a statement recently indicating that some cargoes of contracted soybeans could get canceled or deferred because of low crush margins in China. The official estimated that Chinese consumption for 2010-11 would have to be cut by one million tonnes.

In early February, we estimated that based on trends at the time, 2010-11 global ending stocks might fall to 22% of usage, from 24.7% in 2009-10, which could be considered dangerously close to the levels that represent tightness and which set off the original bull market in 2007. Even if we incorporate the lower inventories, which the USDA did not adjust for in the April crop report, we would still be looking at ending stocks of more than 23% of usage.

The US dollar has been weak, which normally is very supportive for commodity markets, which are priced in dollars. But aside from the petroleum, precious metal, and a few select other markets (corn for example), most markets have backed off their highs and seem to have lost some of their (irrational?) exuberance. Quite possibly because they're responding to developing bearish supply/demand fundamentals. Our stops for nearby beans and meal, at $13.60 per bushel and $360 per tonne, respectively, were triggered. Remain sidelined.

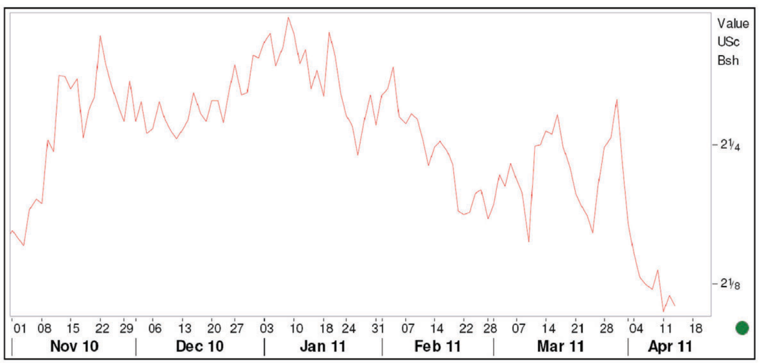
[April 13, 2011]

Chart 5 – July soybeans



Courtesy Reuters

Chart 6 – November soybeans/December corn



Courtesy Reuters

COTTON

Cotton pauses, but Asian buying has not let up

Cotton prices have taken an amazing trip – from 40¢ per pound in early 2009 to a high of $2.27 this past March. New-crop (December 2011) prices never came close to spot prices (Chart 7). Nevertheless, there was a strong assumption that locking in historically high prices – even with new crop at just over $1 per pound – was a large enough incentive for US farmers to expand acreage generously. While US cotton area will still be much larger than last season, the March 31 planting intentions report took traders by surprise.

The average of analysts' guesstimates for 2011-12 acreage was 13.22 million acres, up from 10.97 million acres planted in 2010-11. The actual figure came in 664,000 acres below expectations, at 12.57 million acres. In the sessions following the release of the acreage report, December new-crop prices rallied by as much as 20¢ per pound, or 15%, to new contract highs, before settling back to the breakout level.

Charts 8, 9 and 10 indicate that over the past couple of months, new-crop cotton prices have rallied *vis-à-vis* new-crop prices of potential alternative crops. Responses to the surveys conducted by the USDA – the basis for the planting intentions data – would perhaps be different if those surveys were conducted today. Some analysts suggest that US cotton acreage is probably closer to the analysts' guesstimate than suggested by the intentions report.

In any case, the US, as well as the other major producing countries, will be growing more cotton than they have in the past few years. Indian acreage is expected to jump by 15%. Chinese cotton sowings are estimated to rise by 5% to 10%.

Australia's crop will soon be harvested. Farmers shifted a significant amount of acreage away from grains to cotton for the 2010-11 crop. Production is expected to more than double from 2009-10 output of 1.8 million bales. The USDA estimate is 4.5 million bales, but recent estimates from private Australian analysts puts the crop closer to 4 million bales.

The USDA unexpectedly lowered the estimate for the long-harvested US 2010-11 crop by 220,000 bales in the monthly crop report. Together with a small uptick in mill consumption, the revisions will bring ending stocks down to 1.6 million bales, or 8.2% of usage. That is the lowest carryout in history. At the global level, ending stocks continued to erode as well, falling to 35.5% of usage from the March estimate of 36.3%. That is the lowest carryout since the bull market of the mid-1990s.

The market has had a chance to think about the lower-than-expected 2011-12 US cotton area. As mentioned above, new-crop prices have retreated from the initial burst of excitement.

Demand, of course, is a key issue. US exports are expected to reach a record 15.75 million bales by the time the marketing year ends on July 31. Commitments stand at 15.3 million bales with about 65% shipped, which is about the right pace for this time of year.

The outlook for the booming export market took a bit of a hit with the most recent series of USDA weekly sales reports, but as we'll explain, once you look beyond the headlines not much has changed.

In five of the past six weeks there were net cancellations of old-crop sales. The amounts were not huge – the total was just over 200,000 bales. It could mean that we won't make the USDA export target of 15.75 million bales, and the ending stock figure will not look as dramatically low as it does now.

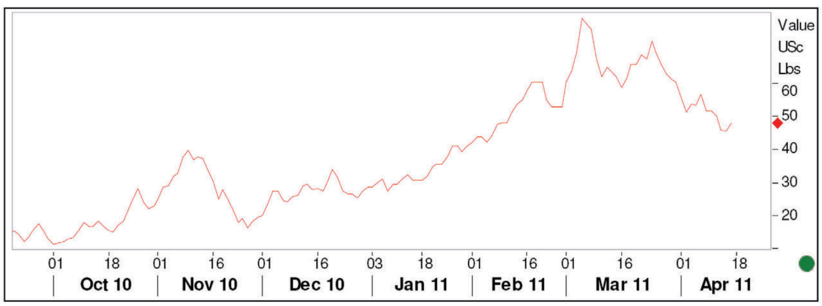
The volume being sold abroad, however, has not changed. Last year, in the comparable six-week period, average weekly new-crop sales were just over 40,000 bales. This year, sales of new-crop (trading at a 50¢ discount to July) have averaged 263,000 bales per week. New-crop sales for 2011-12 have already reached 5 million bales. Last year, new-crop sales in mid-April were barely 700,000 bales.

In the meantime, the weather in Texas, the largest producing state, has been very dry. It is premature to compare 2011-12 US acreage with 2010-11, because the harvested/planted ratio was exceptionally high at 97.6%. The way the weather looks at the moment, it is hard to imagine optimum yields and acreage recovery.

We reiterate our March 9 suggestion to be long new-crop December and to use a $1.10-per-bushel stop.

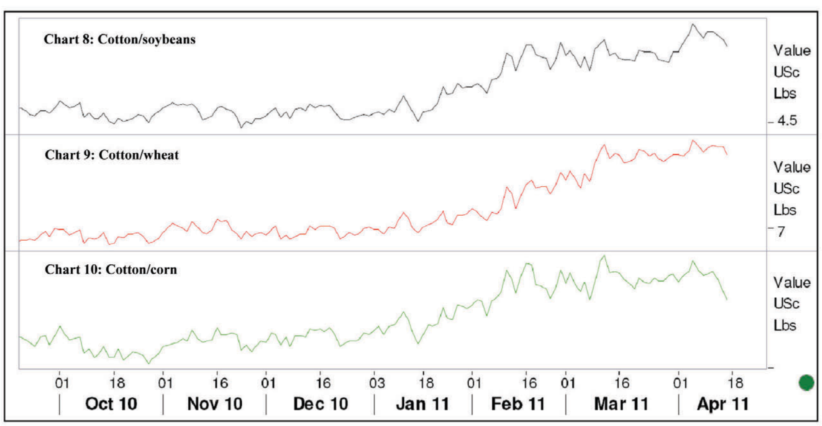
[April 15, 2011]

Chart 7 – July/December cotton spread



Courtesy Reuters

Chart 8, 9, 10 – New-crop spreads



Courtesy Reuters

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Subscription Enquiries for
Friedberg's Focus on Futures
Suite 250
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 Ltd.
Suite 250
181 Bay Street
Toronto, Ontario M5J 2T3
416-350-2903
Attn: Sholom Sanik

For U.S. Persons
Friedberg Mercantile Group, Inc.
Suite 250
181 Bay Street
Toronto, Ontario, Canada M5J 2T3
1-800-461-2700