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Less acreage, more demand equals higher corn prices

The March 31 USDA reports were bullish for both the supply and demand side of corn.

The quarterly stocks report has been notoriously volatile. Traders expected the USDA to “correct” its previous estimate. The January 10 quarterly stocks report estimated stocks on December 1 at 10.426 billion bushels (264 million tonnes), 363 million bushels (9.2 million tonnes) below the average of analysts’ guesstimates. Instead, the new data again surprised the market. March 1 stocks were estimated at 7.005 billion bushels (179 million tonnes), 93 million bushels (2.36 million tonnes) under the average guesstimate. As indicated quite clearly in Chart 1, the bottom of the market coincided with the release of the January 10 stocks report. The new data have extended the recent rally to seven-month highs.

Estimates for ethanol usage have remained steady at 5 billion bushels. For now, this lays to rest fears that demand for the bio-fuel would taper off without generous government subsidies. With robust feed and ethanol consumption, US domestic demand is solid.

Rounding out the bullish demand side is the continuation of strong US exports. Export commitments stand at 41.3 million tonnes, *above* the USDA estimate for annual sales which is 40.64 million tonnes. And there are five months remaining in the marketing year. At 22 million tonnes, shipments are about average for this time of year.

The Chinese government has not yet clarified its position on allowing imports of GMO corn. As we’ve pointed out in the past, however, it is not as large an issue as its made out to be in the news. The USDA estimates total Chinese imports from all sources at 5 million tonnes, a bit under 5% of total world trade. The US has already shipped 2.6 million tonnes, with 1.16 million tonnes of outstanding sales.

The March 31 USDA planting intentions report also surprised to the bull side. US farmers are forecast to plant 91.691 million acres, down sharply from last year’s 95.365 million acres. It was well known that soybeans stood to capture significant acreage from corn (soybean

area is estimated at 81.5 million acres, up from 76.5 million in 2013-14), but the average analyst guesstimate of 92.748 million acres was way off the mark.

The harsh winter weather we had this year should support prices as well because soil temperature is below what is considered normal for planting. Together with rainy weather, planting delays are expected. While this opens an additional vulnerability, it is still very early to worry about late planting. Last year the crop was very late, but excellent growing weather in the latter stages of the summer growing season led to a record crop regardless.

It is widely expected that the Ukrainian crop will be smaller for 2014-15 because farmers will have difficulty obtaining financing for seed and fertilizer due to the financial crisis.

South American crops are now being harvested. Estimates have been volatile, but there shouldn’t be any great surprises.

Despite the record crop harvested in the US last fall, 2013-14 ending stocks will be 20% to 25% below initial estimates because demand has been so strong – particularly exports. Even though global output of 967 million tonnes was a record by far, inventory levels were not rebuilt to comfortable levels because demand for US corn – as illustrated – was much higher than expected. The

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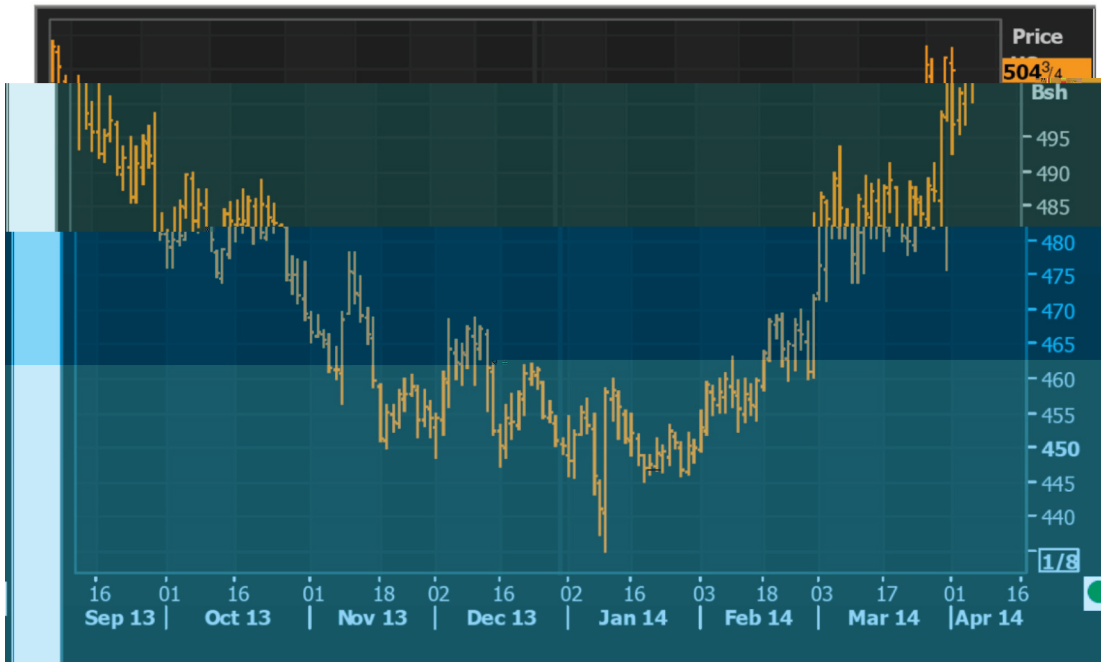
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Chart 1 – December corn



Courtesy Bloomberg LP

The March 31 USDA planting intentions report showed that US farmers expect to plant 11.1 million acres of cotton this spring for the 2014-15 crop that will be harvested in the fall. That would be 700,000 more acres than the previous season, but new-crop contract months rallied on the news because the figure came in 400,000 acres below the average of traders' guesstimates.

It would be a stretch, though, to construe this acreage data as very bullish. The crop has every chance of being much larger than last year's. The abandonment rate over the past three seasons has averaged a much-higher-than-normal 28.7%. That compares with an average of only 10.1% in the previous 10 years – going back to 2001. Normal weather conditions could produce a crop of between 16 million and 17 million bales, which would be up from 2013-14 output of only 13.2 million bales. The February USDA Forum estimate was 16.3 million bales.

Some producing nations seem to be cutting back cotton production in response to burdensome global inventories – but others are not. Overall, it appears that global cotton output will be similar to 2013-14.

For the Southern Hemisphere, Australian production is expected to fall by about 450,000 bales, to 3.65 million bales. Brazilian output, on the other hand, is expected to increase by 1 million bales to 8.4 million bales.

For the Northern Hemisphere, Chinese cotton area is forecast to fall by 9%, leaving output about 2.5 million bales below

The old system is being replaced with direct subsidies to farmers that are expected to encourage them to grow cotton (and soybeans). The shift in policy will – sooner or later – see a reversal in the unrelenting pace of imports of these commodities as the domestic market is flooded with supplies from state reserves.

In May the USDA will release its first comprehensive look at the 2014-15 global supply/demand situation. The figure for Chinese ending stocks is likely to be slashed, which will result in a sharp drop for global ending stocks. Of course, it will merely be a reflection of the destocking and of Chinese domestic demand being met from state reserves rather than from imports.

In 2012-13 Chinese cotton imports from all sources totaled 11 million bales. That was down from the peak reached in 2011-12 of 24.5 million bales. On April 1, a USDA attaché report estimated that Chinese cotton imports in 2014-15 will drop an addition 25% from the current marketing year, to 8.25 million bales.

Production glitches and the usual weather scare will appear. Barring any major crop failures, however, Chinese imports – or lack thereof – will rule the day.

Remain short July cotton, as per our February 26 recommendation. Maintain stops at 94¢ per pound, close only.

[By Sholom Sanik, April 9, 2014]

Chart 2 – December cotton



SUGAR

Getting sweeter all the time

Drought conditions in South America will reduce the 2014-15 Brazilian cane crop by about 40 million tonnes, or about 7% from initial expectations. The average estimate for sugar output in the center south – where 90% of Brazil’s sugar is grown – is 32.9 million tonnes, down from 34.3 million tonnes in 2013-14. The estimates by industry analysts vary widely – from 31 million tonnes to 34 million tonnes. It’s early in the crushing season, and only time will tell. Yields from the drought-stricken cane crop will be one variable. Aside from that, the ratio of cane devoted to

ethanol production will further determine how much sugar is produced.

One issue that has not attracted much attention is the progress of the Indian 2013-14 crushing season. The crush began late because of a dispute over high prices that farmers were charging millers for cane. With world sugar prices between 16¢ and 17¢ per pound, mills were facing bankruptcy if farmers did not bring cane prices into line with world sugar prices. The dispute was settled with government subsidies to millers in the form of interest-free loans.

Thus, milling activity did not get under way in earnest until January. At one point, crushing was 30% behind the same time the previous season. The gap has narrowed. By the end of March, sugar production was still 7% lower than in 2012-13. The Indian Sugar Mills Association forecast recently that sugar output for the marketing year will fall to 23.8 million tonnes, down from early season estimates of 25 million tonnes. That still leaves production and consumption roughly balanced, but may not be the exact scenario the government had envisioned when it liberalized export policies.

With a global sugar surplus in 2013-14, a possible shortfall in India is not a very large concern. Besides, India has been able to shore up its reserves over the past couple of years with bumper crops.

The problem is the outlook for the 2014-15 crop. About 70% of Indian farmland relies solely on rainfall and the strength of the June-through-September monsoon rains is crucial. There is a serious threat from El Niño this year. The last time El Niño caused drought conditions in India, sugar output fell dramatically.

In 2009 rainfall was 23% below normal. Stocks had already fallen from drought in the 2008-09 marketing year. The 2009 El Niño-induced drought caused a second consecutive year of well-below-normal output and saw world sugar prices soar to 35¢ per pound. A moment of reckoning will come soon, as the state-run weather

agency is scheduled to release its first monsoon forecast sometime this month.

Thailand has become an important exporter. Over the past five years annual production has been rising and is now about 60% higher than it was as recently as the 2009-10 season. During this period, exports have risen from 5 million tonnes to 9 million tonnes. When El Niño caused a weak monsoon in 2009, the Thai sugar crop was affected only modestly. With Thailand a major player in the Asian arena now, there is much more at stake. So the monsoon becomes a huge factor as we head into the Asian growing season.

Even with the rally off the 16¢-per-pound lows, world sugar prices are still trading at or below the cost of production, making mills unprofitable. In Brazil this could manifest in a higher ethanol/sugar output ratio, particularly in light of stubbornly high crude oil prices, which pushes ethanol into the competitive zone with petroleum prices. In India it could result in mill closings. Either way, sugar prices will have to work considerably higher to incentivize an expansion of production.

For the longest time, we recommended the purchase of long-dated sugar call options. We are now confident that we've seen the lows, and we are advancing our recommendation to include outright long positions. Buy October sugar, currently trading around 18.25¢ per pound. Place initial sell stops at 17.25¢ per pound, close only.

[By Sholom Sanik, April 11, 2014]

Chart 3 – October sugar



Courtesy Bloomberg LP

PALM OIL

El Niño and palm oil

El Niño – the weather system that is defined by warmer-than-normal temperatures in the Pacific Ocean and that wreaks havoc with weather all around the globe – is back. The disturbance can cause anomalous weather conditions – drought in some regions and excessive precipitation in others. The frequency of El Niño varies – there have been five since 1997. Current ocean temperatures in the pertinent areas are similar to those recorded in the 1997 event, which was the most powerful El Niño on record. Meteorological services have thus confirmed that the early signs of El Niño are present.

We recently mentioned El Niño regarding its potential impact on the sugar market in India (see *Focus on Futures*, April 14). The vegetable oil market may be another area of concern. As shown in Table 1, production is heavily concentrated in just a few regions.

The USDA estimate for total global production of vegetable oil in the current 2013-14 marketing year is 169 million tonnes. Palm oil is the largest component, comprising 58 million tonnes, or 34% of the total. Soybean oil output is second at 45 million tonnes, or 27%. Rapeseed oil and sunflower oil round out most of the balance, making up 15% and 9%, respectively. These four oilseed markets account for 85% of total output.

Table 1: Global vegetable oil output (millions of MT)

| | |
|--------------|---------------|
| Indonesia | 35.54 |
| China | 23.21 |
| Malaysia | 21.49 |
| EU | 17.18 |
| US | 10.15 |
| Argentina | 8.25 |
| Brazil | 7.99 |
| Other | 45.73 |
| TOTAL | 169.54 |

Based on USDA estimates for the 2013-14 marketing year, Indonesia and Malaysia produce a staggering 86% of the world's palm oil, which in turn is about 35% of total global vegetable oil output.

As far as El Niño is concerned, palm oil is among the

most vulnerable commodities. By representing such a large share of the total vegetable oil market, a meaningful drop in new palm oil supplies can have widespread repercussions, not only for palm, but for the other vegetable oils as well.

Drier-than-normal weather has already appeared in both countries, but the full force is not expected to be evident until later in the year.

Although it's a bit early to be predicting a worst-case scenario, there is enough evidence to suggest that there will be some fallout. Some analysts estimate that palm oil output in Indonesia and Malaysia could fall by as much as 30%.

To draw a picture of what the global vegetable market could look like if Murphy has his way, consider the following: Global ending-stock levels for vegetable oils are typically very low when compared with other commodities – over the past five years they've averaged about 10% of usage. Crop failures can therefore tighten the market quickly.

Between domestic consumption and exports – mainly exports – Indonesian and Malaysian output is completely consumed. A 30% drop in Indonesian and Malaysian palm oil production would slash total global vegetable output by 10%, to about 150 million tonnes.

With global domestic consumption running at about 165 million tonnes – we could be looking at a 15-million-tonne production/consumption deficit for the coming marketing year. With negligible inventories, the other oil markets would be strained to the maximum.

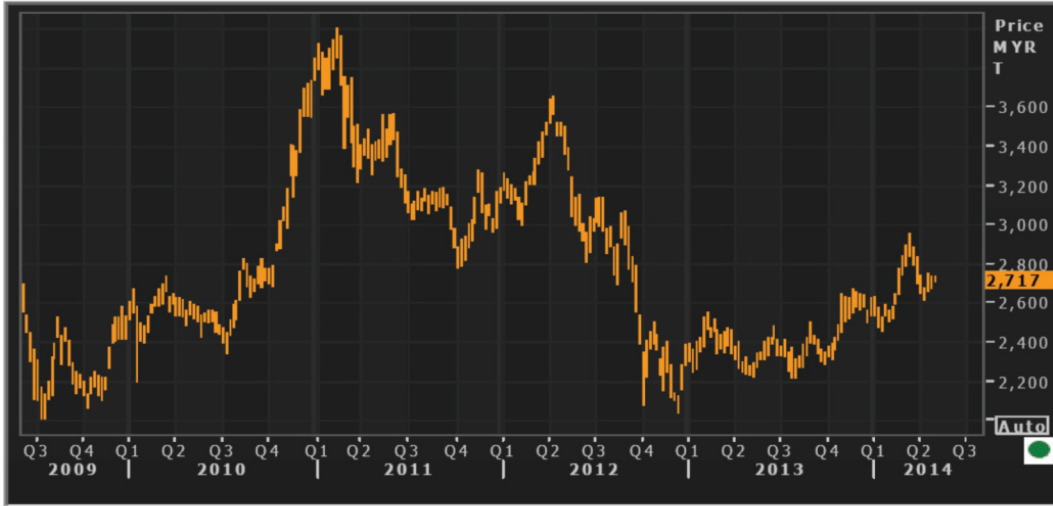
The other oilseed that could be in harm's way of El Niño – albeit in a much smaller way – is India's rapeseed crop. Indian crops rely heavily on healthy June through September monsoon rains, but past El Niño events have brought severe drought to key growing regions. India grows about 10% of the world's rapeseed.

Oilseed traders will be on high alert for weather-related issues. Palm oil prices began to rally out of a year-long sideways range when El Niño talk began to surface, but have now backed off a bit (Chart 1). Palm oil futures trade in Kuala Lumpur and are denominated in Malaysian ringgits, which adds risk of currency fluctuation. In addition, the market trades only during Asian business hours.

If tightness were to develop in the global vegetable market, demand for soybean oil would be the next beneficiary (Chart 2). We therefore suggest establishing long positions in December soybean oil.

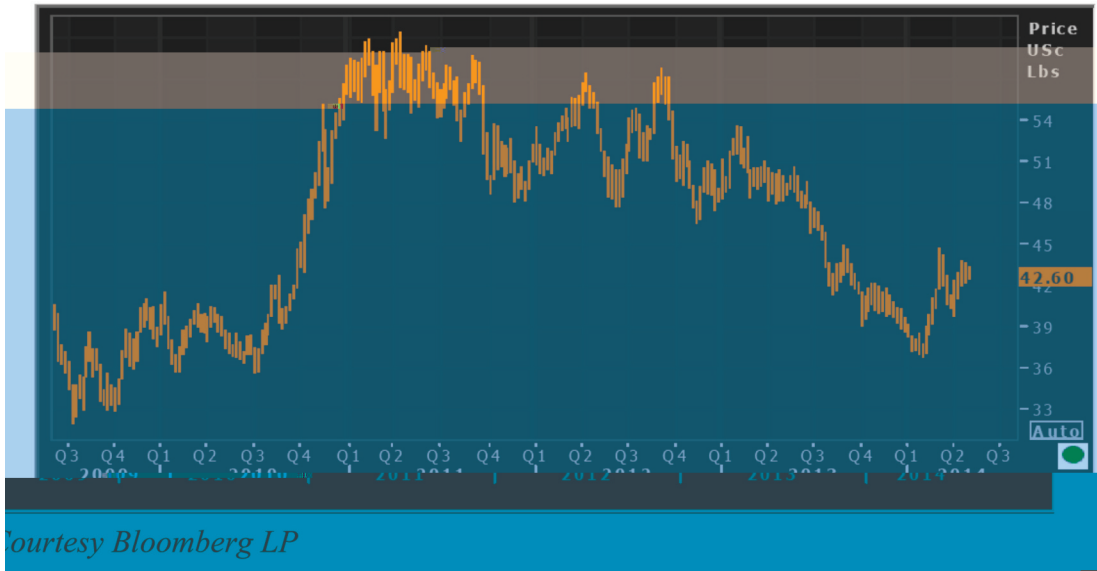
[By Sholom Sanik, April 28, 2014]

Chart 4 – Weekly palm oil



Courtesy Bloomberg LP

Chart 5 – Weekly soybean oil



Courtesy Bloomberg LP

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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

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