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Cocoa: record crops amid tepid demand

After collapsing from above \$3,000 per tonne to below \$2,000 per tonne over the past year and a half, cocoa prices have been attempting to bottom. Most recently, the market is drifting back towards its April lows (Chart 1). West African crop estimates have wavered since the 2016-17 marketing year began last fall, but with the main-crops complete and the mid-crops continuing to outperform, record and near-record crops seem to be in the bag.

Port arrivals in the Ivory Coast are through the roof. According to the government's marketing agency, the Coffee and Cocoa Council, arrivals as of June 30 reached 1.88 million tonnes, compared with 1.41 million tonnes at this time last year. Output has already surpassed the record set in 2014-15 of 1.8 million tonnes.

Weekly arrival figures for the tail end of the Ivorian mid-crop have been running at an above-average pace. There should be little challenge in topping 2 million tonnes for the first time.

The latest figures for Ghana show that the number-two producer will also beat earlyseason estimates. To date, output has reached 882,000 tonnes, 12% above last year at this time and its highest level since 2011.

Cocoa butter prices have been sluggish, while powder prices have been rising. The combined butter/powder ratio shows that product prices have remained in a tight range over the past couple of years. Product prices have not outperformed bean prices enough for processors to increase bean purchases beyond short-term requirements.

The European second-quarter grind was 2.1% higher, year-over-year. The street was expecting to see some better results owing to the steep drop in bean prices, but as illustrated, the incentive is weak because product prices have been contained. North American processors will report second-quarter grind results later this month.

The growth rate of the Ivory Coast processing industry continues to outperform the traditional grinding regions. For the first half of 2017, grindings were 14% higher than

the same period last year. But in itself, this does not represent any sharp increase in end-user demand. European chocolate manufacturers have been shifting their operations to origin countries. According to the International Cocoa Organization (ICCO), global demand grew by only 3.2% in 2016-17. When pitted against output growth of 18%, the uptick in Ivorian grinding does not mean very much.

The ICCO estimates that for 2016-17, there will be a global production/consumption surplus of 382,000 tonnes. That's up from a *deficit* of 192,000 tonnes the previous season. Ending stocks as a percentage of consumption will rise to 41.8%, up from 33.9% in 2015-16. That's burdensome.

The extremely bearish case is not a done deal. Mitigating it somewhat is recent flood damage to significant parts of Ivorian growing regions. That casts doubt on the potential for another bumper main-crop in 2017-18. Commodity funds remain heavily short, so any bullish news could trigger a material rally.

The evidence, however, suggests that cocoa will be in a state of ample supply for the foreseeable future. We recommend lowering stops on short positions from \$2,150 per tonne, suggested on May 4, to \$2,050, basis September, close only. *[Sholom Sanik, July 12, 2017]*

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Chart 1 – September Cocoa

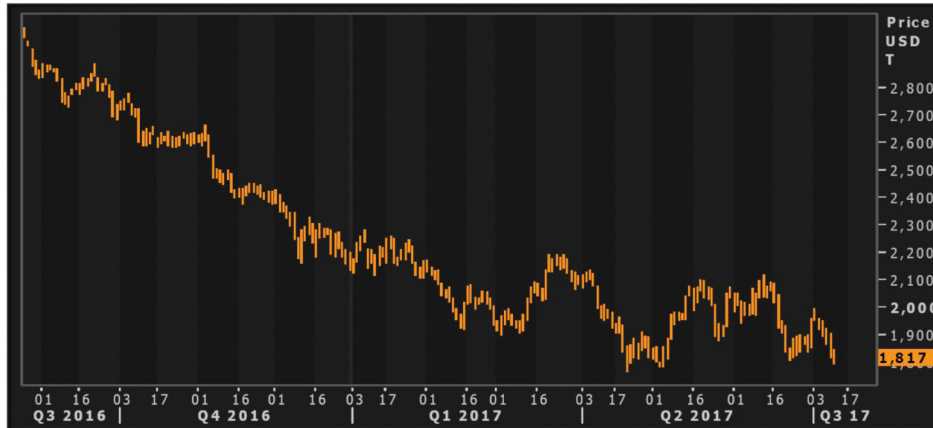


Chart courtesy Reuters

Chart 2 – Combined cocoa butter/powder ratio

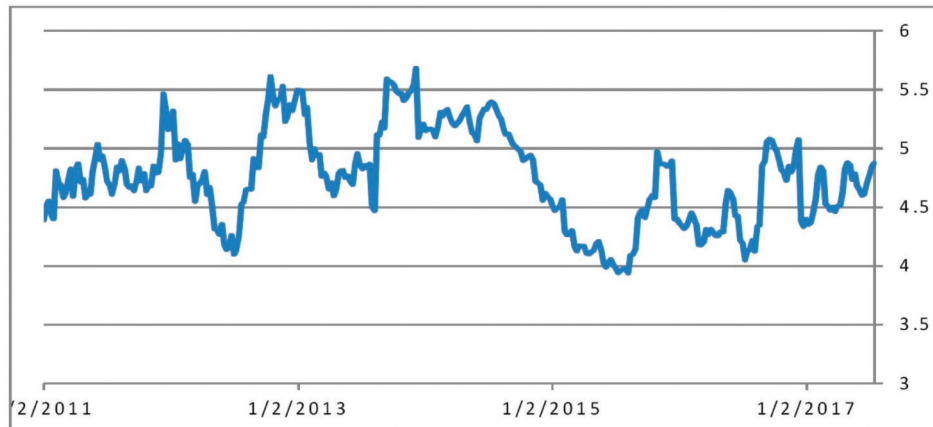


Chart source Reuters

CORN

The USDA surprises with its outlook for US crop

There were three key early-summer USDA reports for corn. All were bearish. Traders ignored the first two and sent corn prices to new highs for the move. The third report brought the market all the way back to the bottom of the long-held trading range.

The June 30 quarterly stocks report showed that US stocks as of June 1 stood at 5.2 billion bushels, 100 million bushels higher than expectations. That was probably the least influential of the lot.

Also on June 30, the first planted acreage report increased estimated corn area to 90.9 million acres, 900,000

acres more than forecast in the March planting intentions report. Analysts actually had been looking for acreage to fall slightly from the intentions report.

Which brings us to the July crop report. The USDA used the June 30 acreage estimate, so there was no surprise in the implied output increase for the 2017-18 crop of 190 million bushels. But traders were surprised by the USDA standing pat on the yield estimate at 170.7 bushels per acre (bpa). The average guesstimate was for a downward revision to 169.6 bpa.

The weather had remained dry ahead of corn's key pol-

mination stage. According to the USDA's most recent weekly crop condition report, the good-to-excellent portion of the crop fell 3 percentage points from a week earlier, to 65%. That compares with 76% last year at this time. However, last year the weather was excellent, and growing conditions were ideal.

It's likely that the USDA did not lower yields in the crop report to reflect current crop conditions because the five-year average for good-to-excellent at this time of year is only 63%. And in most years the crop muddles through the bad moments and comes through just fine. Certainly a bad stretch – such as we saw over the past month – creates vulnerability. By no means, though, is it time to hit the panic button.

In addition, the USDA raised 2016-17 Argentinean output by 1 million tonnes.

Mostly as a result of the upwardly revised increase to the forecast for the US crop, the estimate for 2017-18 global ending stocks rose to 18.8% of consumption, up from the June estimate of 18.3%. As we pointed out in our last discussion of corn (see *Focus on Futures*, May 23), demand has increased at a faster pace than can be met by bumper crops in the US and South America. As such, global inventories are still trending downwards, even after the USDA's optimistic view of the US crop. Ending stocks in 2015-16 and 2016-17

reached 22% and 21.6% of usage, respectively.

Commodity funds have been covering their shorts as the market sprinted to one-year highs over the past couple of weeks and are now net long. A return to favorable growing conditions in the US Midwest will undoubtedly see funds re-establish their presence on the short side.

As long as the growth rate for demand remains stronger than the growth rate of production, we believe that corn prices have limited downside.

Even if the USDA is on target with its yield estimate, global production will be down 3% from last year while consumption is estimated to grow by 1%. In an environment in which ending stocks are trending downwards, that hardly has the complexion of a bear market.

Although we've been bullish on account of dwindling global inventories, we did not participate in the weather-scare rally. We were stopped out of our long position just before the weather turned dry. But with the bearish reaction to the USDA's reluctance to lower yields, we're back near the bottom of the trading range.

We're going to recommend standing aside for the moment until there is more clarity on the US weather picture. But stay tuned.

[By Sholom Sanik, July 14, 2017]

Chart 3 – December corn

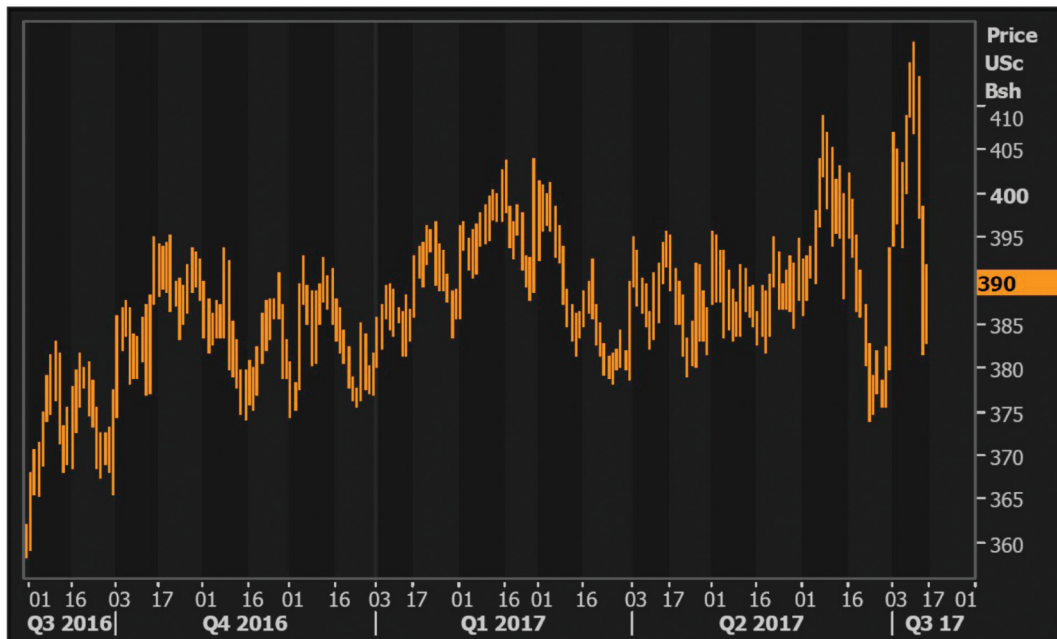


Chart courtesy Reuters

SOYBEANS

Brazil will cushion a US soybean crop failure

Recent key USDA reports for soybeans presented a mixed picture.

Analysts were expecting the USDA to raise its estimate for 2017-18 US planted area by 268,000 acres above the March intentions report, but the increase was only 31,000 acres, to 89.51 million acres. It would be a stretch, however, to put a bullish spin on this report in light of the massive expansion from the 2016-17 area of only 83.43 million acres.

The quarterly stocks report showed that June 1 stocks were 20 million bushels below expectations, but that's a small miss and was therefore inconsequential as well.

The July crop report was more interesting. With many weather-related problems in the US – flooding in some areas and drought in others – traders were anticipating that the USDA would lower its projected bushel per-acre yield. But, like corn (see *Focus on Futures*, July 14) the USDA took its usual conservative approach and kept yields virtually the same as those in the June report. Bean prices dropped by about 60¢ per bushel over the next two sessions (Chart 4).

The most recent crop progress report shows that the good-to-excellent portion of the crop dropped by 1 percentage point from the previous week, to 61%, which compares with 71% last year at this time. But then again, and similar to corn, the five-year average for this juncture of the growing season is only 60%.

So while traders and analysts (present company included) tend to get a bit excited about the potential for bad weather to decimate the crop, we get weather scares *every* year, and we always look for reasons why this one is different.

History has shown, however, that over the past few decades, there has been only a handful of years for which yields were compromised in any serious way. Otherwise, technological advancements have made for hardy seed vari-

eties that allow crops to bounce back even after spending part of the season in stress. Chart 5 shows the steady growth of US soybean yields over the past 20 years, albeit with the occasional off year.

Of course, there have been enough crop failures over the years that inspired some serious bull runs. The early going in the Midwest and other soybean areas certainly qualifies for a potential reduction in yields.

There is a mitigating factor, however, that could limit any gains. We always talk about how once the South American harvest is in, US exports take a back seat. That was never more true than it is now. Chart 6 shows the ratio of Brazilian output vis-à-vis US output from the time that Brazilian farmers began a serious expansion of soybean crops. In the space of 15 years, Brazil went from growing just about half as much as the US to growing just about as much as the US. This year's Brazilian crop will reach a record 114 million tonnes compared with US output of 117.2 million tonnes.

According to the latest USDA estimate, as a result of the steady upward revisions to the Brazilian crop, global ending stocks for 2016-17 now stand at a record 28.60% of consumption. That's up from the five-year average of 23.64%.

A US crop failure would have to be 1988-89 style – when yields dropped by 20% from a year earlier – to have an appreciable effect on global supplies.

The weather market stopped us out of our short position in November beans, recommended on May 8, at \$9.65. We advise staying clear of trading soybeans until we have a better idea of just how serious crop losses in the US may be. Until then we should bear in mind that even with the rather sloppy crop progress indicated above, yields remain within the confines of the five-year trendline.

[By Sholom Sanik, July 19, 2017]

Chart 4 – November soybeans



Chart courtesy Reuters

Chart 5 – US soybean bushel-per-acre yields

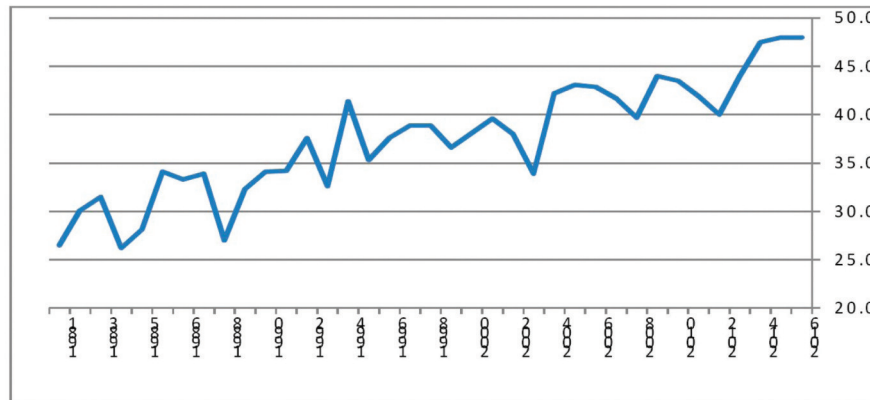


Chart source: USDA

Chart 6 – Ratio Brazilian/US soybean production

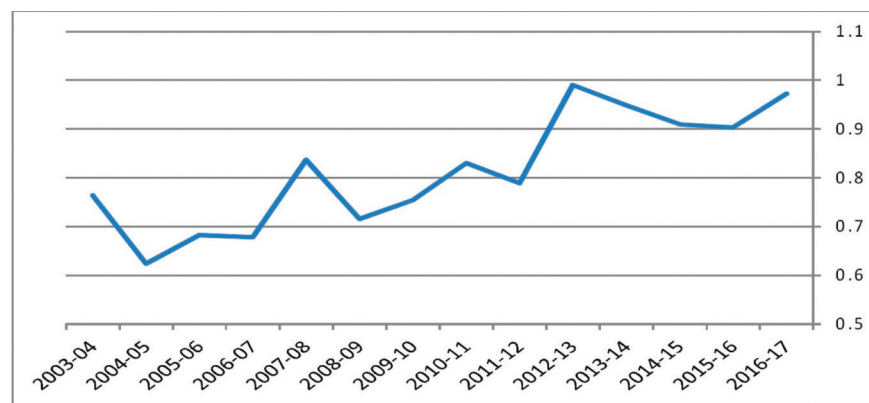


Chart source: USDA

COTTON

Is China coming back to the table?

Cotton prices have dropped sharply this summer as traders focus on expanded US acreage (Chart 7). March 31 planting intentions showed that US farmers were going to plant 12.23 million acres for 2017-18, up from 10.07 million acres the previous year. The street was expecting the June 30 acreage report to show an increase, but the USDA surprised traders with a downward revision of 170,000 acres, to 12.06 million acres. In the July 12 monthly crop report, the USDA revised its yield estimate slightly higher, from 810 pounds per acre, to 816 pounds, somewhat mitigating the effects of the lower acreage estimate.

Even with the downward revision, cotton acreage will be the largest since 2012-13, and at 19 million bales, the crop will be the biggest since 2010-11.

The market has been trending upwards since the release of these reports, however, because the weather has not been cooperative. The most recent weekly crop progress report shows the good-to-excellent portion of the crop at 55%, down 5 percentage points from a week earlier, and down

from a peak of 66% earlier in the growing season. If the weather does not improve, we expect the USDA to reverse its upward yield revision in the August crop report.

The two other large producing nations, India and China, are expected to have larger crops as well. Output is estimated at 29 million bales and 24 million bales, compared with 27 million bales and 22.75 million bales, respectively.

China continues to draw down its inventories. Chinese stocks peaked in 2014-15 at 66 million bales. By switching from imports to selling off its burdensome stockpiles, those stocks are now down to 39 million bales. As a result, global ending stocks have fallen from 101% of consumption in 2014-15 to the current estimate of 75%.

The USDA target for the outgoing marketing year's exports is 14.50 million bales. We may come up a bit shy of that figure, but it will still be the most cotton the US has sold abroad since the 2010-11 marketing year. The forecast for 2017-18 is for a setback to 13.50 million bales. We believe that this estimate is conservative because export commit-

ments for 2017-18 already stand at close to 5 million bales, their highest level for this time of year since 2010-11. In the years between, average commitments for the upcoming new marketing year on this date averaged only 2.4 million bales.

Total Chinese imports for 2017-18 are estimated at 5 million bales, the same as in 2016-17, and down dramatically from a high of 24.5 million bales in 2011-12.

It will be some time before China will again be the force on world cotton trade that it once was. But we reiterate the point that we've been making over the past year: The burdensome stockpile reportedly contains unusable cotton for export and – sooner or later – Chinese imports will start increasing. Some evidence of this already exists: As we near

the end of the 2016-17 marketing year, although accumulated US exports to China are still well below the five-year average, they have more than tripled compared with last year at this time (Chart 8).

We have a bullish bias because we believe that the steep drop in Chinese imports is at or near its lows. A US crop failure would certainly be bullish, but the crop can muddle through early-season weather problems.

We recommended liquidation of our long position on June 14. If the USDA were to revise its estimate for 2017-18 Chinese imports upwards, we would be far more interested in reentering the long side. For now, remain sidelined, but stay tuned.
[By Sholom Sanik, July 30, 2017]

Chart 7 – Ratio Brazilian/US soybean production



Chart courtesy Reuters

Chart 8 – Ratio Brazilian/US soybean production

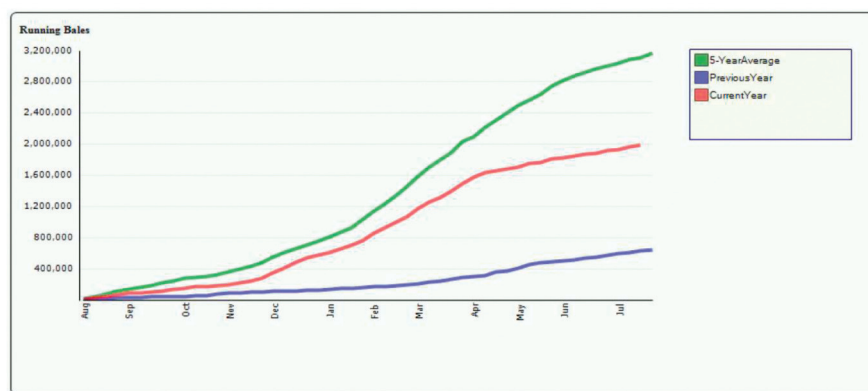


Chart courtesy USDA

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