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Soybeans: on missing the boat

Until late spring, soybean prices were propped up by a devastating drought in Argentina that resulted in a steep plunge in production. Output for 2017-18 is estimated to fall by 30% from the previous season, to 37 million tonnes. While quite the blow for Argentinean farmers, in the grand scheme of things, the US and Brazil both had ample supplies to compensate. This was evidenced clearly by the subsequent $2-per-bushel, or 20%-plus, plunge in new-crop prices (Chart 1).

For the most part, supply/demand fundamental data releases have been bearish.

On June 29, the USDA acreage-update report for the 2018-19 crop increased the estimate for US soybean area by 575,000 acres from the March intentions report. In itself, this wasn't all that bearish because the actual figure was 134,000 acres below the average of analysts' guesstimates.

The July crop report presented a broad bearish picture for the 2018-19 marketing year, though. For supply, the forecast for global output was raised by more than 4 million tonnes, to 359 million tonnes. That compares with 337 million tonnes in 2017-18. Most of the gains came from higher estimates for South America. For the moment, anyway, we don't put much stock in this because these crops will not be planted for several months yet and are not harvested until next spring. As this past season amply illustrated, many things can go wrong.

In fact, although analysts are forecasting a 5% increase in Brazilian soybean area for this fall's planting, it may be a bit premature to call another record crop for Brazil. The government settled a trucking strike recently by setting minimum freight prices. This will drive up the cost of fertilizer, and as a result, analysts estimate that fertilizer purchases will fall by close to 4%, which in turn could leave the crop vulnerable.

On the demand side, the estimate for global consumption was lowered by 3.4 million tonnes from last season. In the notes accompanying the July crop report, the USDA cited the 25% Chinese tariff on soybeans imported from the US as a factor in lowering total Chinese imports by 5 million tonnes.

All told, the revisions contained in the July crop report translate into a materially different balance sheet than we saw in June. Global ending stocks for 2018-19 will rise to 98.27 million tonnes, or 27.7% of usage. That compares with 24.3% in June. Although global consumption should still be about 4% higher than in 2017-18, the higher output estimates and the perceived drop in Chinese demand dispel any hope of eating away at burdensome global inventories. Ending stocks reached 29.4% and 28.3% in 2016-17 and 2017-18, respectively. So the sharp jump to 27.7% from June approaches the levels seen over the past few years.

The trade war should affect Chinese buying to some degree. Brazilian prices have jumped sharply. The premium over US prices is equal to about 80% of the value of the 25% Chinese tariff on US imports, which means that the Chinese are buying Brazilian beans, and all other foreign purchasers are buying their soybeans from the US. So for the moment, the fallout from the trade war for soybeans is close to neutral.

Back in the spring, we were correct in assessing that "The Argentinean crop failure is very much *in the market...*" (see *Focus on Futures*, May 4). However, and there really is no other way to describe this, we chickened out. As we were heading into the US planting season with forecasts for a smaller crop, we advised liquidating November $10 soybeans puts at breakeven.

China grows but a fraction of their protein meal requirements. So they will import soybeans, whether it is Brazilian beans or US beans diverted to other countries. As such, we will once again – with some hesitation – invoke the "in the market" argument and say that the market is oversold, partic-

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ularly because we are looking at a hot summer in the US, and the crops are hardly in the bag. The plants are generally in good shape, but are still in the early development stage, and this past week's USDA weekly progress report showed a two-percentage-point decline in the good-to-excellent portion from the previous week.

Still, it remains a well-supplied market, and we recommend using 50¢-per-bushel rallies to establish a short position in March soybeans.

[By Sholom Sanik, July 19, 2018]

Chart 1 – November soybeans

Chart courtesy Reuters

COCOA

Strong demand has not derailed the bear

After the Ivory Coast produced a record cocoa crop of more than 2 million tonnes for the 2016-17 marketing year, prices plunged. The market began 2018 near multi-year lows, but fears that Ivorian output would falter for the 2017-18 season sent the market flying. Prices jumped by more than 50%, to just shy of the $3,000-per-tonne mark (Chart 2). Most recently, the market has shed 50% of those gains. Where to from here?

We're about half-way through the mid-crop, which runs through the end of August, and total port arrivals (mid- and main-crop) stand at 1.824 million tonnes, 63,000 tonnes, or 3.6%, below last year at this time. Earlier in the season that gap was over 10%.

The early-season concerns were overblown – not only for the Ivory Coast, but for the other significant West Africa producer as well. At one point in the season, estimates called for Ghana to grow just over 700,000 tonnes, down from 850,000 tonnes a year earlier. One analyst now puts the crop at 900,000 tonnes. These two countries produce roughly two thirds of the world's cocoa beans, so whatever happens with their production is nearly all we need to know about supply.

On the demand side, product prices improved with the price of beans for a while, and for the most part, the effects of higher product prices have been reflected in grind activity. The EU is the world's largest grinding region and has now recorded above-average gains for three consecutive quarters. The Asian grind showed some extraordinary year-over-year increases as well (see Table 1).

Table 1: Cocoa – Grinding results in key regions

Region	2017 Q4 %	2018 Q1 %	2018 Q2 %
EU	4.4	5.5	7.3
Asia	4.2	7.2	15.0
N. America	-1.28	-1.14	-3.11

Only the North American region continues to dwindle. Bearing in mind that Western Hemisphere grinding activity consists of only about one-third that of the EU in recent years, it is becoming less of a factor as the industry on this side of the ocean slowly fades. Grinding activity is shifting to origin countries.

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Traders could have been justifiably stunned at the reaction to the all-important EU grind. On July 16 the market was trading close to the high of a six-week range. The average of analysts' guesstimates was for a 3% increase. Initially, the market reaction to a 7.3% jump was consistent with the implications of the largest year-over-year quarterly gain in many years. Prices spiked by close to $100 per tonne. But by the close of the session, prices had nosedived, creating the largest one-day range that anyone can recall. In technical parlance, the market left a classic, textbook, outside-day reversal, closing below the previous day's range (Chart 3).

The Asian grind, which came in at plus 15%, against an expectation of a 6% increase, was reported on July 20. While the market rallied a bit in response, prices subsequently continued on to five-month lows.

In fact, it's not much of an enigma at all. The past several quarters reflect higher product prices late last year and earlier this year. But the grind data are now behind the market. Both butter and powder prices have slipped back. Butter prices, the key ingredient in chocolate production, peaked in early 2018 at 3.5 times London spot beans, but that ratio has since fallen to 2.9.

The combined ratio, which measures the ratio of butter and powder prices versus the price of London beans is down substantially over the past few months (Chart 4).

The final word went to traders who realized that the spectacular grind results are now ancient history. The prices of the products have followed the beans down, and as such, the incentive to grind beans at the pace we saw over the past three quarters has vanished. The third-quarter grinds are not likely to sustain these trends.

Remain short December cocoa as per our May 30 recommendation. Lower protective buy stops to 2,650 per pound, close only.

[By Sholom Sanik, July 24, 2018]

Chart 2 – Weekly nearest contract ICE cocoa

Chart courtesy Reuters

Chart 3 – December ICE cocoa

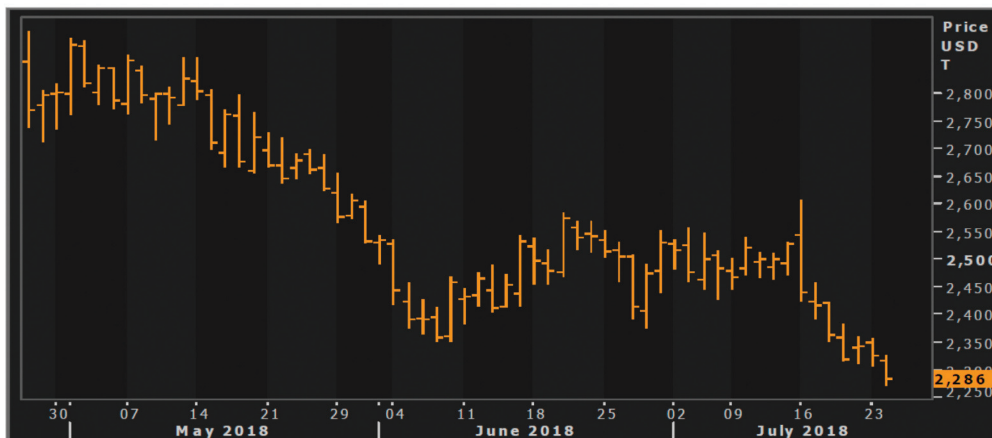

Chart courtesy Reuters

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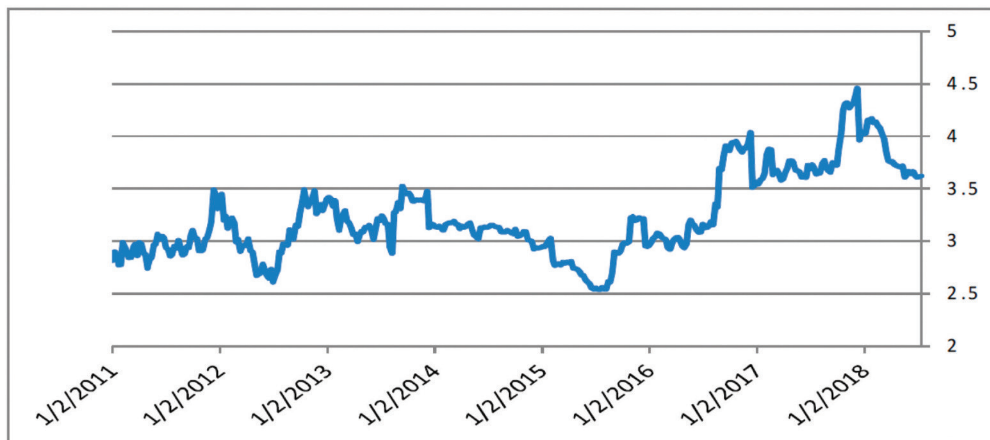
Chart 4 – Cocoa: combined butter/powder ratio



Source: Reuters

COTTON

China up against a wall

Cotton prices traded up to four-year highs in early June. The market subsequently experienced a steep correction, with the most prominent culprit being concern over the 25% tariff that China was set to impose on US imports starting on July 5 (Chart 5). December cotton fell about 13% before finding its footing and has now retraced roughly half the losses. The diagnostics that we monitor continue to be bullish.

The June 29 USDA acreage update was expected to show a small increase in area planted for the US 2018-19 crop – which it did. However, the increase was smaller than the average of analysts' guesstimates. The actual figure came in at 13.52 million acres, 49,000 more acres than the June estimate, but the street was looking for an increase of 312,000 acres. The market extended its slump after the acreage report, but as seen clearly in Chart 5, it was within days of what now seems to have been the bottom of the correction.

The world balance sheet continues to tighten. For the US, the July USDA crop report incorporated the larger acreage figure, but the output estimate fell regardless. The estimate for the harvested-to-planted ratio dropped to 78%, down from the June estimate of 82%. To get an idea of how the hot, dry weather has affected this year's crop, consider the harvested-to-planted ratios of 94% and 88% in 2016-17 and 2017-18, respectively. The production estimate was revised downwards by 1 million bales, to 18.5 million bales.

The estimate for Indian output rose by 200,000 bales, to 28.70 million bales, compared with 29 million bales in 2017-18. We were a bit surprised by this because private forecasters have been working with estimates that put planted area at least 10% lower than the previous season.

More significantly, though, the early part of the June through September monsoon season was looking fairly normal. Recently, however, forecasters have issued warnings that the weather system – so vital to Indian agriculture – is only 92% of normal.

Chinese output was maintained at 26.5 million bales, down 1 million bales from last year.

Significant historical revisions were made to the demand side. Aside from bumping up the estimate for 2018-19 Chinese demand by 1 million bales, the USDA also increased its estimate for consumption by 1 million bales each for 2016-17 and 2017-18.

As a result of these changes, the global balance sheet is starting to take on a whole new complexion. The ending-stock estimate for 2018-19 dropped sharply, to 77.84 million bales, or 61.3% of usage, compared with the June estimate of 66.2% and the 2017-18 carryover of 69.5%.

After the June increase of 1.6 million bales, the USDA kept Chinese imports at 7 million bales. We'd venture that it's almost a given that foreign purchases will continue to grow. The 16-million-bale production/consumption deficit forecast for 2018-19 will be a record, and ending stocks have been whittled down. Chinese mills require better quality cotton than is grown in China, a demand that historically has been met by the US and Australia. Australia has struggled with drought, and the new-crop is estimated to drop from 4.9 million bales in 2017-18, to 3.7 million bales – so not much help there.

Which brings us to the US and the 25% tariff the Chinese have imposed on US cotton imports. Now, that presents a quagmire for the Chinese. For soybeans, the Chinese can turn

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to South America. Brazil is expected to grow a bumper cotton crop of 9.5 million bales, and that is an option for now. However, before China embarked on its destocking program, foreign purchases were over 20 million bales! We're not saying that China is anywhere close to that level of imports, but if the usable inventories have indeed run dry, the USDA is underestimating Chinese import demand. Chinese mills may simply have no choice but to buy US cotton.

We were stopped out of our long position in December cotton as per our June 11 recommendation. Reestablish long positions in December cotton. Place initial sell stops at 82.50, close only. *[By Sholom Sanik, July 26, 2018]*

Chart 5 – December ICE cotton

Chart courtesy Reuters

CORN

A bountiful US crop vs. tight global inventories

The upcoming August USDA crop report will present the first survey-based production estimates for the 2018-19 US corn crop. The USDA has maintained its 174-bushel-per-acre yield (bpa) forecast since the first estimate of the season back in May. Spring planting weather was favorable, and for the most part in most regions, growing conditions have been quite good as well. As of the most recent weekly crop progress report, the good-to-excellent portion of the crop stands at 72%, compared with 63% last year at this time. The crop condition is the sixth best for this time of year since 1989.

The sharp drop for the recently harvested South American crops is well known to the market. The July crop report showed 2017-18 Brazilian and Argentinean output at 83.5 million and 33 million tonnes, respectively, down from 98.5 million and 41 million tonnes in 2016-17. More recent estimates show that these numbers are likely to be revised downwards. One prominent US analyst puts the Brazilian crop at 80.1 million tonnes.

The primary focus, however, will be on the new estimate for the US crop. In all probability, the 174 bpa estimate is extremely conservative. Last year the final yield was 176.6 bpa with growing conditions that were challenging at times. Leading up to the report, we've seen a very broad range of guesstimates, from 175.4 bpa to 179 bpa. Were the estimate to come in at the high end, with a steady harvested-acres estimate, we're talking about an increase in production of about 400 million bushels (10 million tonnes), to 1.464 billion bushels (371 million tonnes).

A 179 bpa yield will certainly trigger a bearish reaction, and we can expect a selloff. However, when put into perspective of the global balance sheet, corn inventories are still struggling. If we plug in an additional 13 million tonnes – say 3 million for Brazil and 10 million for the US – to the current

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global ending stocks estimate, the number rises to 164 million tonnes, or 15% of consumption. The additional supply, however, would still leave a second consecutive season of production/consumption deficits – 36 million tonnes for 2017-18 and 40 million tonnes for 2018-19. In our proposed model, the ending stock figure should be higher than the July ending-stock estimate of 13.9% of usage, but still materially lower than the 21.5% and 17.8% we saw in 2016-17 and 2017-18, respectively.

Over the past several years, US farmers have addressed growing global demand and perceived greater profitability for soybean planting at the expense of corn acreage. Consider that since the 2015-16 marketing year, US planted soybean acreage rose, from 82.7 million acres to this year's 89.7 million acres. Corn acreage fell from 94 million acres in 2016-17 to this year's 89.1 million acres.

Looking a bit further down the road, if the trade war between China and the US continues, US farmers are almost certain to adopt a more cautious approach to soybean planting and shift at least some of those acres back to corn. China hardly imports any corn at all, so corn is not in the eye of the tariff storm. It would be safer to plant corn.

With global inventories for corn far tighter on a comparative basis with soybeans (15% vs. 24.4% of consumption), we believe that the trend of rising soybean area and falling corn area has ended.

The USDA's August 10 bpa estimate revision for corn is the hot issue for the moment. A strong number would quash the recent rally. On the other hand, given the relatively tight global balance sheet, corn prices remain vulnerable to weather-related glitches. At this time we continue to watch from the sidelines. *[By Sholom Sanik, August 6, 2018]*

Chart 6 – December corn

Chart courtesy Reuters

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