FRIEDBERG'S

FOCUS ON FUTURES

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Wheat: bearish data, bullish action

The 30¢-per-bushel rally we saw in the wheat market in October was inspired primarily by the belief among traders that US government purchases of wheat for donation to Afghanistan and other needy Third World countries would tighten the US balance sheet. The donations, though, were hardly large enough to make a significant impact. Aside from these assumptions, there has been little in the way of bullish developments during this period. As a result, the "Afghan rally" has faded.

Indeed, traders have had a fair bit of bearish news to deal with, the most recent being reports that China, India, Russia, and Pakistan – none of which have traditionally been significant exporters – were seen active in the export market. China's entry to the World Trade Organization may be useful for a psychological boost, but will provide no support until actual Chinese purchases are seen.

Poor 2001-02 crops in major exporting countries, such as Australia and Canada, were seen by many as a sure bet that an already tight global market would eventually cause wheat prices to break out on the upside. The Canadian crop will be 5.5 million tonnes, or 20.5%, below last year's. Australia's crop has improved considerably from bleak forecasts earlier in the season but will still come in at 1.77 million tonnes, or 7.4%, less than the previous season. This has been known for months, though, and might have continued to be important were it not for rather sharp upwards revisions to the crops of other producers.

Over the past two months the USDA has raised FSU production by 7.38 million tonnes, to 89.86 million tonnes. This is reflected in the December USDA supply/demand situation report. The forecast for 2001-02 ending stocks rose by 3.72 million tonnes over last month, to 143.98 million tonnes. This marks the fourth month in a row that the forecast for ending stocks has been increased. In August, stocks as a percentage of consumption stood at 22%. With the December report, that figure had grown to 24.1% of consumption.

The USDA lowered its estimate of US exports – always a key indicator for this market – by 680,000 tonnes, to 27.22 million tonnes. This accounted for most of the 950,000-tonne increase in the forecast of US ending stocks.

Early fall sales from late September through the end of November were quite strong. Average weekly sales during this period were 612,000 tonnes compared with a weekly average of 489,000 tonnes during the same period last year. Average sales for the past 6 weeks fell back to only 442,000 tonnes compared with 477,000 tonnes last year during this period. Total export sales and shipments are running 911,000 and 1.295 million tonnes respectively behind last year at this time.

As illustrated, the fundamentals of this market do not leave bulls a whole lot to hang their hats on. Yet, we've once again acted on our long-held bullish bias and have taken a long position in this market. Why?

Let's put things in perspective. Yes, carryover stocks have been growing recently, but we have to remember that the big picture is still quite bullish and leaves wheat vulnerable to any sudden change in consumption or weather patterns. Wheat remains the only major commodity that we know of whose output has been shrinking – consistently. The global

In this issue

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

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wheat market last recorded an increase in production in the 1997-98 season. Since then, output has decreased every year. This year, at 577 million tonnes, global wheat production will be 5% lower than it was at the peak in 1997-98, at 609 million tonnes. Consumption has grown enough to draw stocks down from 170 million tonnes (29.28 % of consumption) at the end of 1997-98 to the current estimate of 144 million tonnes (24.15% consumption).

The two-percentage-point rise in global ending stocks over the past few months is definitely a significant development. We find the market's relative strength somewhat puzzling, though. As illustrated, since 1998, the world supply/demand balance has been tightening steadily. There was not much bearish news for bulls to worry about during this period. Despite this, the market was confined to a rather narrow range of $2.40 to $2.80 per bushel (Chart 1), and saw plenty of false breakouts. The kind of bearish news we've seen lately would have sent the market quickly back to the bottom of the range in years past. Yet the market has been quite strong, with March wheat (Chart 2) seeing solid support at $2.80 per bushel, a level that was a stubborn resistance area until recently.

Furthermore – and this is the most convincing reason to be long this market – the March/July spread has a tendency to tighten from mid-year until the harvest is in (Chart 3), but then collapse. This season it has yet to narrow. Our conclusion is that the statistics must be a bit behind the market. There is little else that could explain the strength in price accompanied by an alleged bear market that is only a hair's-breadth from backwardation.

[December 17, 2001]

STRATEGY: *Remain long March wheat as per Flash Update of December 6. Maintain stops at 278, close only.*

Chart 1 – Nearest Contract Wheat

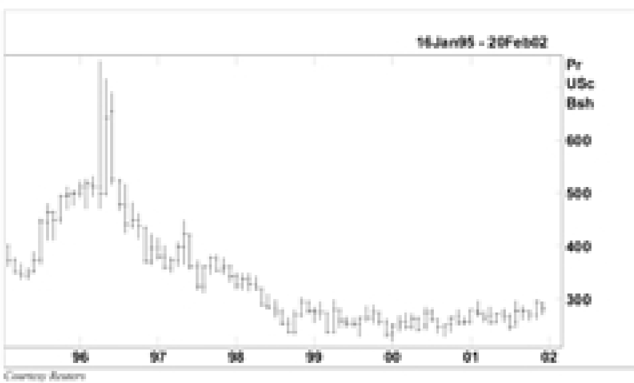


Chart 2 – March Wheat

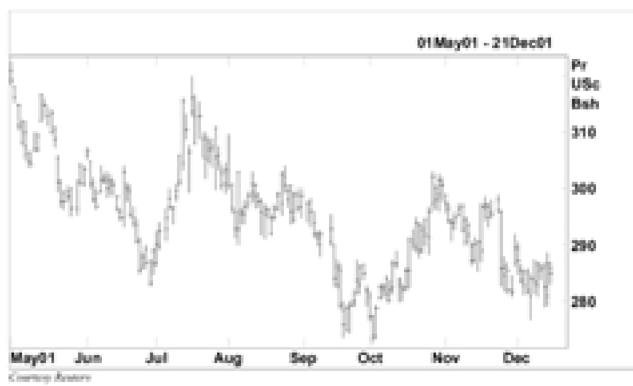
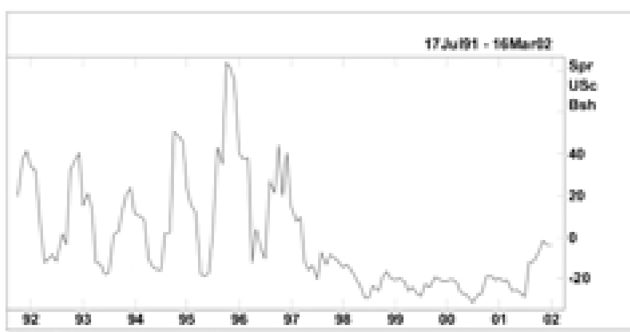


Chart 3 – March/July Spread



COCOA

The bull pauses, but just to catch its breath

The bulk of the rally in the cocoa market over the past six weeks was not accompanied by any particularly bullish news. Arrivals data out of West African producing countries were scarce, leaving traders with little useful information to work with. To understand the strength, we hypothesized that arrivals must be running behind last year's pace. By the end of November, however, reports began to trickle in, indicating that this was not the case. Ivorian arrivals totaled over 400,000 tonnes vs. 200,000 tonnes at the same time in the 2000-01 season. Ghanaian arrivals were about 130,000 tonnes vs. 100,000 tonnes last year. The market barely blinked. Prices maintained their bullish poise.

On December 4, E.D.&F. Man released its first report since September, finally providing the market with some concrete data to justify the rally. Despite the strong pace of arrivals, Man lowered its estimate for the 2001-02 Ivorian crop by 65,000 tonnes from its September report, to 1.235 million tonnes. Man predicted that a weak tail to the main crop would cause the rate of arrivals to drop off sharply towards the end of December. In addition, prospects for the mid-crop were poor because early pod setting was weak. The Ivorian revision was the most important bullish item contained in the report, but the forecast for the Ghanaian crop was lowered as well, by 15,000 tonnes, to 435,000 tonnes. More on that later.

The demand side is a different story. Man is looking for a decline in grindings of 0.5% in 2001-02. Still, the drop in output was enough for Man to raise the estimate of the deficit by 50,000 tonnes to 150,0000 tonnes. This would draw stocks down close to 940,000 tonnes, marking the first time, Man points out, since the 1987-88 season that ending stocks will be below 1 million tonnes. Obviously, this level of stocks is a far more critical issue now with consumption having grown by some 50% since that era. Ending stocks, as a percentage of consumption, will be drawn down to 30.9%, compared with 32.6% in the September report and 36.3% at the end of the 2000-01 season.

Last month (*Focus on Futures*, November 20) we calculated that stocks would be drawn down as low as 27% of consumption. We maintain that opinion, even though it would require all the worst-case scenarios to play out. Some evidence has emerged to support this theory. Just the other day, Ghana's cocoa board – citing the spread of black pod disease – revised the size of its crop downwards by 30,000 tonnes from its own previous estimate.

The problems that caused the sharp drop in the 2000-01 Ivorian crop have not gone away. As we've been saying all along, it is difficult to imagine that the crop will turn out any bigger than last year's. If it were even the same as last year's – 1.185 million tonnes – we would have to revise the deficit higher by another 50,000 tonnes.

In September, Man forecast a 1% increase in 2001-02 grindings, but has revised this outlook to a decrease of 0.5%, because of weak processing margins. For most of the 2000-01 season, Man forecast a flat rate of growth for grindings. Its final figures for 2000-01, however, show that grindings grew by 2.6%. There is not much hard evidence to the contrary, but we suspect that Man has taken a very conservative approach.

Demand in regions with low per-capita consumption is expected to rise. Consumption in Japan, for example, has been growing each year. Together with better-than-anticipated grindings that we've witnessed over the past two years, we are optimistic that demand will remain firm. Besides, the spreads don't lie. The 12-month spread is at its highest level in modern history (Chart 4). For anyone who has been watching this historically oversupplied market, this backwardation is truly an awesome sight.

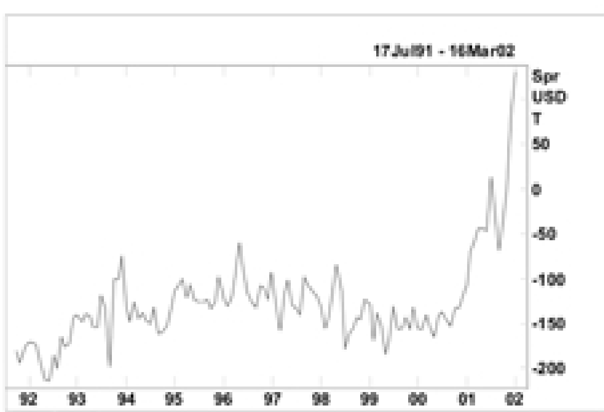
One uncomfortable reality to bear in mind is that the news has been behind the market. It is hard to ignore the fact that the market has not made a new high since the release of the Man report, even though it represented a solid confirmation that we will emerge from this crop year with a formidable deficit. The market did not respond favorably to the downgrade in the Ghanaian crop, a further indication that the market has already priced in a 400,000-tonne crop rather than the early season forecasts for a robust 450,000-tonne crop.

Having said that, we should also point out that open interest has been very contained, indicating that the strength cannot be attributed solely to speculative activity. While CFTC data show that commodity funds are now net long, the position is moderate by recent standards. To illustrate, at the end of June, funds were net short 16,648 contracts. The most recent commitment data show that they are net long only 5,651 contracts. While this is the largest net long position the funds have carried in some time, we should remember that we've been in a lengthy bear market in which rallies complemented by juicy contangos were quickly pounced on by speculators. With the contango formation now ancient history, we expect funds to acclimate themselves to the backwardation environment. There could be ample buying ammunition waiting on the sidelines.

In conclusion, we realize that we woke up a bit late and have not spent more than a few fleeting moments on-side since we took on our long position. We are very clear, however, that we are in a long-term bull market. The best is yet to come. *[December 20, 2001]*

STRATEGY: *Remain long March cocoa as per Flash Update of December 12. Maintain stops at 11.90 close only.*

Chart 4 – One-Year Spread



PLATINUM

The Russians are at it again

From mid-1999 through mid-2001, platinum, palladium, and rhodium enjoyed a powerful bull market. These platinum group metals (PGM) benefited primarily from rapid growth of the auto catalyst market as governments around the globe implemented legislation to curb environmental damage caused by engine exhaust. Russia, a producer of a disproportionate amount of the world's supply of these strategic commodities – 20% of platinum and 65% of palladium – allowed itself to get tangled in an awful mess of red tape involving export license legislation that kept any significant supply off the market for about a year. This lethal combination of demand and supply issues allowed prices to skyrocket.

Eventually, prices reached irresistible levels, and the Russian PGMs began to show up on world markets. The return of Russian supplies coincided with the global economic downturn, and prices fell faster than they rose. The steep losses seem to have leveled off.

Chart 5 shows platinum prices superimposed on a chart of the CRB. Platinum prices behaved much as most other commodities did this year, i.e., weakness, second round of weakness after September 11, and then bottoming action. Any comparison with other commodities, though, should end there. The fundamentals of many commodities, even those such as cotton and wheat where we believe bear markets have ended, do not possess the more permanent bullish characteristics of platinum.

First of all, although the internal workings of the Russian bureaucracy remain opaque, its intentions regarding the PGM markets are rather transparent. There have already been rumblings about supply interruptions, particularly for palladium. Long-term contracts with Japan, which accounts for 20% of world consumption of both platinum and palladium, expire at the end of 2001. But Almaz, the Russian export agency responsible for issuing export licenses, has not provided any indications to dealers about whether new licenses would be forthcoming.

Few of the other markets we look at – save for cocoa – have such a high concentration of output centered in so few places. This bullish fundamental is permanent. As long as the Russians want to play this game, platinum users will remain vulnerable to restricted supplies and price spikes.

Another issue that sets platinum apart from most other commodities is the delicate balance between production and consumption. Production is just barely keeping up with rising consumption. According to Johnson Matthey's (JM) most recent report, published in September, global production will increase this year by 290,000 ounces, to 5.58 million ounces. Consumption, however, will rise by a like amount of 280,000 ounces, to 5.94 million ounces, leaving yet another deficit of 360,000 ounces. There has been a global production/consumption deficit in four out of the last five years. Demand has grown by an average of 3.6% per annum, while new mine production has grown by only 2.5% per annum during this period.

One of the factors that allowed platinum prices to fall close to $250 per ounce from their peak early this year was the belief that new and expanded projects in South Africa would begin to fill the gap between supply and demand. Although South African output is still estimated to increase by 280,000 ounces over last year, JM reports that output would have grown by an additional 200,000 ounces were it not for technical problems associated with some expansion projects and labor difficulties that plague the country. JM believes that these problems will persist and that expectations about South African production increasing by yet another 500,000 ounces next year are not realistic.

In its report, JM calculates that if all expansion projects in South Africa are realized, it would be mining 5.5 million ounces by mid-decade. Just the other day, South Africa's Chamber of Mines leapfrogged JM's estimate for mid-decade South African production, estimating that the country would be churning out closer to 7 million ounces per year by 2006. JM doubts if even its own estimate of 5.5 million ounces can be achieved, because mining companies will be reviewing their expansion plans given the current economic climate.

Jewelry demand, which accounted for half of global demand last year, fell rather sharply this year, dropping 310,000 ounces, to 2.52 million ounces. This clearly is a reflection of the weak economic environment. However, auto catalyst demand grew by 470,000 ounces, more than compensating for slow jewelry sales.

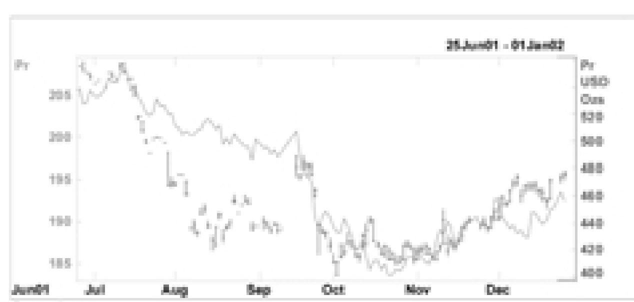
In conclusion, for now, we find that the bear has run its course in the platinum market. South Africa may indeed produce enough a few years down the road to put the market back into balance. For a market that suffers from concentration-of-supply problems, however, it is no great comfort to know that output will become even more concentrated in a region that is not at the top of the list of stable political environments. In any case, we have yet to see the kind of production increases that would allow South Africa to reach even the more modest estimate by 2006.

The far more pressing and imminent problem to worry about, though, is the ability of the Russians once again to restrict exports in a bid to drive prices higher in a market that is running deficits and has no known carryover stocks of substance. They've done it before, and they can do it again.

We have a bullish bias, and we are watching the market carefully with an eye to entering the long side. *[December 27, 2001]*

STRATEGY: *Stay tuned.*

Chart 5 – January Platinum (bar), CRB (line)



SOYBEANS

Huge South American crops overwhelm a very bullish export market

After a rally in November pushed March soybeans to better than $4.5 per bushel and semi-respectability, bean prices have slipped back and are making fresh contract lows. We are now close to breaking down below the long-held support level of $4 per bushel. Can anything save this market from a $3 handle?

There are only three countries in this market that grow enough beans to matter – the US, Brazil, and Argentina – and the evidence provides conflicting indications.

The progress of the Brazilian crop would certainly seem to signal that lower prices are just around the corner. On December 26, Brazilian grain analyst Safras e Mercado raised its estimate of the Brazilian crop from just a month ago by 700,000 tonnes, to 43 million tonnes. This compares with the USDA's last estimate of 41.5 million tonnes and would represent a 10.8% increase over last year's crop. The USDA raised its forecast for the Argentinean crop in its December supply/demand situation report as well by 750,000 tonnes, to 28.75 million tonnes, compared with the previous season's 27.2-million-tonne crop. Together, the two countries are expected to export 26.5 million tonnes in 2001-02, compared with 23 million tonnes in 2000-01, and only 15.3 million tonnes in 1999-00.

The South American duo are certainly cutting into the US slice of total global market share. On the surface it would be difficult to see how the US could avoid building up burdensome ending stocks, particularly after coming off a record harvest of 79.55 million tonnes.

Last month we noted that weekly sales were running far ahead of sales for the same period the previous season. The torrid pace was unsustainable, but sales have still been running at a pace that is consistent with meeting and probably even exceeding the USDA forecast for annual exports of 27.22 million tonnes. At 808,000 tonnes, average commitments for the past 4 weeks are now running behind the same period last year (990,000 tonnes) and have slowed considerably when compared with the average of 1.17 million tonnes for the previous 4 weeks. For the season, though, we are still very far ahead of last year. Total commitments stand at 19.8 million tonnes compared with 16.9 million tonnes at this point last season.

We also voiced concerns over the fact that despite the strength in commitments, actual shipments were running behind the previous year. This could be an indication of panic buying that will ultimately result in a higher-than-typical rate of cancellations. However, over the past few weeks, shipments have jumped out ahead of last year's pace. As of today's USDA weekly export report, US exporters have now shipped 11.7 million tonnes of soybeans compared with 10.33 million tonnes last year at this juncture.

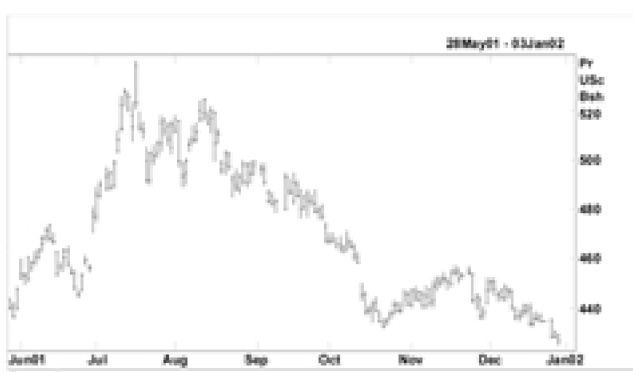
The USDA raised its forecast for 2001-02 US exports this month by 550,000 tonnes, to 27.22 million tonnes. On the surface it would seem that the USDA has taken an extremely conservative approach, considering that last year, US exporters sold 27.17 million tonnes and then we're running so far ahead of last year in both commitments and shipments. The obvious explanation, however, is that US sales will run into stiff competition when the South American harvest becomes available in a few month's time.

According to the USDA's December supply/demand situation report, global carryover stocks are forecast to fall to 16% of consumption compared with 16.5% in 2000-01 and 16.8% at the end of 1999-00. But when we make the adjustment for more up-to-date forecasts for the Brazilian crop by adding 1.5 million tonnes to supply, we find 2001-02 ending stocks back at 1999-00 levels of 16.8% of consumption.

The market is weak and looks lower. We are not looking at the short side, because we are close to historically low levels, and we believe the downside is limited. Watch US exports carefully. If they continue to be as strong as they've been, we will be looking for a spot to enter the long side of this very cheap commodity. *[December 28, 2001]*

STRATEGY: *Stay tuned.*

Chart 6 – March Soybeans



HOTLINE UPDATE

***Flash Update* – Wednesday, December 5, 2001:**
Good morning for Wednesday, December 5, 9:30 am. This is a Flash Update. We have sold short March silver at 415.50, placing our initial stop at 427, close only.

***Flash Update* – Wednesday, December 5, 2001:**
Good afternoon for Wednesday, December 5, 4:30 pm. This is a Flash Update. We have covered our short December mini S&P position at 1170. We repeat our Flash Update of this morning, where we sold short March silver at 415.50, placing our initial stop at 427, close only.

***Flash Update* – Thursday, December 6, 2001:**
Good morning for December 6, 9:30 am. This is a Flash Update. We have purchased March wheat at 285.25, placing our initial stop at 278.5, close only.

***Flash Update* – Friday, December 7, 2001:**
Good morning for Friday, December 7, 11:30 am. This is a Flash Update. We have covered our short March silver position at 429.

***Flash Update* – Friday, December 7, 2001:**
Good afternoon for Friday, December 7, 1:50 pm. This is a Flash Update. We have purchased March cotton at 38.20, placing our initial stop at 35, close only. We repeat our Flash Update of this morning, where we covered our short March silver position at 429.

Friday December 7, 2001:
Good afternoon for Friday, December 7, 4:30 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are long March sugar, with our stop revised to 7.50; long February gold, with our stop at 260; long March wheat, with our initial stop at 278.5; and long March cotton, with our initial stop at 35. All stops are close only.

***Flash Update* – Tuesday, December 11, 2001:**
Good afternoon for Tuesday, December 11, 1:30 pm. This is a Flash Update. We have liquidated our long March sugar position at 7.48.

***Flash Update* – Wednesday, December 12, 2001:**
Good morning for Wednesday, December 12, 9:10 am. This is a Flash Update. We have purchased March cocoa at 1322, placing our initial stop at 1190, close only.

***Flash Update* – Thursday, December 13, 2001:**
Good afternoon for Thursday, December 13, 2:25 pm. This is a Flash Update. We have liquidated our long March cotton position at 35.30.

Friday, December 14, 2001:
Good afternoon for Friday, December 14, 4:35 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are long February gold, with our stop at 260; long March wheat, with our stop at 278.5; and long March cocoa, with our initial stop at 1190. All stops are close only.

Friday, December 21, 2001:
Good afternoon for Friday, December 21, 4:45 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are long February gold, with our stop at 260; long March wheat, with our stop at 278.5; and long March cocoa, with our stop at 1190. All stops are close only.

Friday, December 28, 2001:
Good afternoon for Friday, December 28, 4:35 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are long February gold, with our stop at 260; long March wheat, with our stop at 278.5; and long March cocoa, with our stop at 1190. All stops are close only.

Subscription Enquiries for
Friedberg's Focus on Futures
P.O. Box 866, Suite 250
BCE Place, 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
P.O. Box 866, Suite 250
BCE Place, 181 Bay Street
Toronto, Ontario M5J 2T3
(416) 350-2903
Attn: Sholom Sanik

In U.S.
Friedberg Mercantile Group Inc.
67 Wall St., Suite 1910
New York, N.Y. 10005
(212) 943-5300