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# Soybeans: not bad for a bearish report

After a production season in which almost everything that could go wrong actually did, the mid-harvest November USDA crop report was as crucial to soybean-market participants as these reports get. The 2009-10 US crop was planted late, because heavy spring precipitation made fields too wet to plant. As a result, the crop matured later than it would have in a typical year, which made plants vulnerable to early frost. Some regions did in fact experience frost. Rain in some areas during October and November delayed the harvest even further, which left the affected areas susceptible to yield loss.

In the weeks leading up to the release of the data, reports of crop damage surfaced. Most analysts, however, were confident that the crop had not only muddled through, but that the USDA estimate would come in above the October estimate. They were right, but the crop was even larger than most expected. Anecdotal reports of abandoned acres and the like turned out to be no match for the resources of the USDA's survey teams. The average guestimate was 3.262 billion bushels, just above the 3.25-billion-bushel October estimate and considerably higher than the 2008-09 crop of 2.967 billion bushels. The number came in at 3.319 billion bushels (90.34 million tonnes).

Save for a 20-million-bushel upward revision to the US export estimate (more on that later), the picture painted by the November report was extremely bearish. The estimate for 2009-10 US ending stocks jumped to 270 million bushels, or 8.5% of consumption, up from October's 230 million bushels. While still shy of the mid-decade stock levels that reached the 500-million-bushel range, it seemed that we had taken a sharp turn away from the bull market territory that saw US ending stocks plunge to 4.5% of consumption at the end of 2008-09.

Revisions on the international front provided more evidence that producers responded to higher prices by ramping up output. A drought-plagued 2008-09 chopped Argentinean output by 30% from the previous season, to 32 million tonnes. Production is expected not only to bounce back, but to soar to a record-by-far 53 million tonnes, up 500,000 tonnes from the October estimate. Brazilian output was revised up by 1 million tonnes, to 63 million tonnes, a record as well.

As such, the market's reaction was strange. The initial selloff after the release of the report did not even take the active January contract below the low of the recent range (Chart 1). Two weeks later, we're trading 70¢ per bushel above the level of the market's close the night before the report. Blaming the weak US dollar is convenient, but it doesn't really wash in this case, because the dollar is actually higher than it was at the time of the report.

In a world where consumption for commodities has either flatlined or contracted, soybeans have been a standout. Global consumption is expected to grow to 233 million tonnes in 2009-10, up 6% from last season. China has been the driving force, importing to meet what seems to be an insatiable appetite for US soybeans. Export commitment data show that US foreign sales stand at 26 million tonnes this marketing year – which began September 1 – 9.6 million tonnes above last year at this time. Chinese purchases comprise 15.8 million tonnes of total US sales, compared with only 8.3 million tonnes at this time last year.

Even after the USDA's upward revision for US exports, the forecast is only 3.3% above last year, absurdly shy of what is indicated by export commitments.

Skeptics argue that it is well known that the magnitude of the volume is such that most of the soybeans being purchased by China cannot possibly be consumed by industry, but rather, are being purchased to bolster inventory levels. From what we know, that assumption is valid. If the Chinese buying spree comes to an abrupt halt, the other international customers do not require anywhere near the amounts that would be needed to keep up the export pace. We will then

## Inside

**Cocoa:** A bearish bull? ..........................................2
**Cotton:** Smaller crops justified? ................................4
**Corn:** Aging bull stayin' alive......................................5

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have to monitor the shipment pace to see if the Chinese actually meet their commitments.

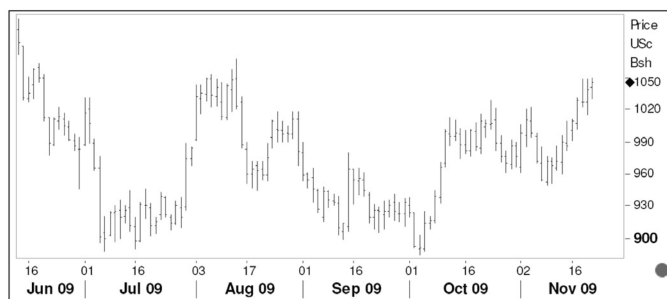
To date, total US shipments stand at 8.9 million tonnes. While ahead of last year at this time, there is so much left to ship that cancellations will remain a threat. On the other hand, soymeal commitments that have a limited shelf life and are targeted directly for industry use are near double last year's levels.

As has been the case in most years since the two large South American soybean producers began to increase their soybean crops by exponential levels, the early estimates may be overshooting what can be realistically expected. Large swatches of the Argentinean growing areas have been plagued by drought. Although timely rains have appeared, it is believed that there has already been significant crop damage.

With global ending stocks projected to jump to 24.5% of usage at the end of 2009-10, it would be difficult to recommend taking on long positions with beans over $10 per bushel. If you managed to hang on to the current-crop/next-year crop spread of long January/short November after it traded at a post-report new low, then continue to hang on.

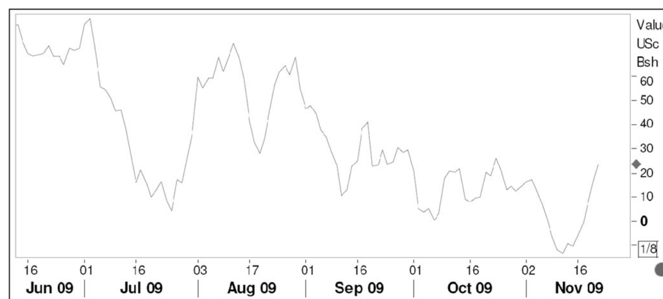
*[November 23, 2009]*

**Chart 1 – January soybeans**




*Courtesy Reuters*

**Chart 2 – January/November spread**




*Courtesy Reuters*

## COCOA

# A bull market with bearish fundamentals?

Many commodities have maintained historically high price levels – in some cases, even after supply/demand fundamentals have turned downright bearish. Of course, all commodities priced in US dollars rose to adjust for the currency's 2009 plunge. The Dollar Index has tumbled by 20% since its February peak. Cocoa prices have jumped by as much as 50% from their 2009 lows (Charts 3, 4, and 5).

This simple model would seem to suggest that cocoa prices are overvalued, particularly since the bulk of evidence suggests that bullish supply-side fundamentals have turned bearish and that the bearish demand-side picture has not improved.

For most of the 2008-09 marketing year, Ivorian arrivals were running about 15% behind the previous season, which would have shaved about 200,000 tonnes off global ending stocks. The arrival pace picked up towards the end of the season, and in early October the official Ivorian output figure was released at 1.178 million tonnes, down 13.85% from 2007-08. On October 12, due to "late reporting by some exporters," the official figure was revised up, to 1.221 million tonnes, down only 10.7%.

Indeed, the market treated this revision as unexpected bearish news, with a heady $170-per-tonne plunge on October 12. The bullish case took a big hit.

In the October 13 issue of *Focus on Futures*, we correctly advised that the market would shrug it off and that traders should concentrate on upcoming events. This would include a revival in demand as economies around the globe slowly climb out of recession and the uncertainty about the size of the 2009-10 crop. Despite the late-season uptick, the crop was still considerably below average size. Aging plantations and poor maintenance remained a problem. Another crop of equal size would still draw global ending stocks down further.

Thus far, however, both of these issues have unfolded to the bearish side.

In stark contrast to 2008-09, the new-crop year in the Ivory Coast began with a bang. Only two months into the season, port arrivals have reached 335,000 tonnes, compared with 207,000 tonnes at this time last year.

The demand side is an even greater disappointment. Third-quarter grind data showed only slight losses for European and North American processors, but 2008-09 was a dismal year overall for consumption. Analysts at Fortis estimate that 2008-09 global usage fell by 5.5%-6% from the previous season. They're looking for a significant recovery in 2009-10, with a forecast for consumption growth of 4.5% to 5%. But we're not aware of any indicators suggesting that we are anywhere near a demand recovery. Asian butter ratios bottomed this past summer, but have improved only marginally since then (Chart 6) and remain stuck at depressed levels we haven't seen since 2003. European butter ratios continue to fall (Chart 7). As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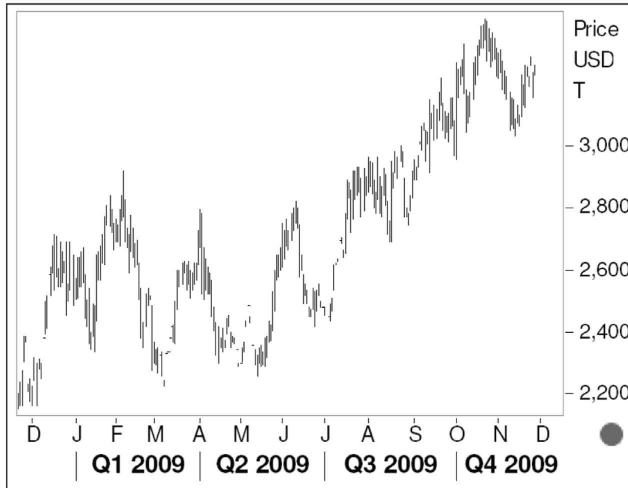
long as profit margins remain at depressed levels, processors will not be motivated to increase bean purchases.

Certainly in the short term, one would have to conclude that this bull run has overstayed its welcome.

One sobering thought for bears: Ivorian arrival activity seems to represent a complete recovery in production. While 335,000 tonnes this early in the season is definitely constructive, 2007-08 arrivals two years ago at this time were just below 400,000 tonnes. So the long-term trend in Ivorian production is still down. Still, a gentle downwards slope in output can be absorbed easily if consumption remains flat.

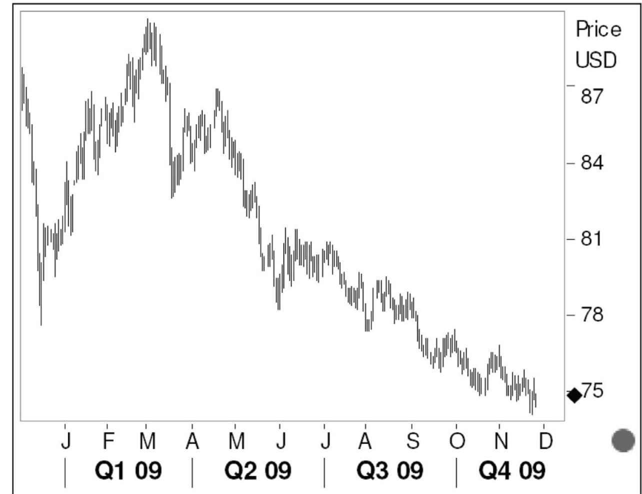
As long as commodity-mania remains intact, so can the bull market in cocoa. We seriously doubt, however, that it could survive any substantial rally in the US dollar. Our current long recommendation dates back to June 1, and we don't want to give up too much of those profits. Continue to maintain conservative and manageable long positions, and use $3,100 per tonne, basis the nearest contract, as a good anytime stop. *[November 27, 2009]*

**Chart 3 – Nearest contract cocoa**



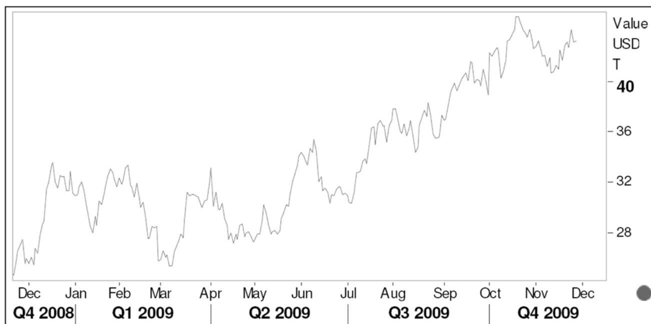

*Courtesy Reuters*

**Chart 4 – Dollar index**



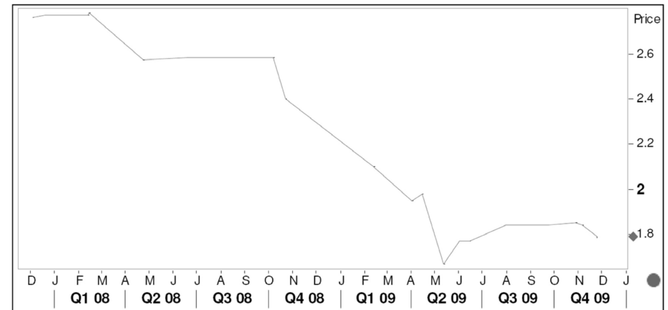

*Courtesy Reuters*

**Chart 5 – Cocoa/Dollar index ratio**



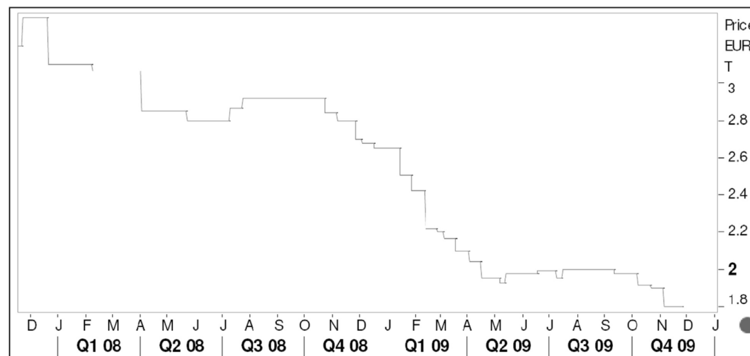

*Courtesy Reuters*

**Chart 6 – Asian butter ratios**




*Courtesy Reuters*

**Chart 7 – European butter ratios**




*Courtesy Reuters*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## COTTON

# Is demand sufficiently weak to justify much smaller crops?

Cotton prices touched an 18-month high just prior to being stung by the Thanksgiving Day Dubai debt crisis – right along with all other commodities (Chart 8). Inasmuch as US dollar weakness and liquidity-related commodity investment play a role in the cotton market, the rally has become vulnerable. As far as cotton-specific fundamentals are concerned, we believe the bull run is still very much intact.

The weakest link remains US domestic mill consumption. The November 25 Census Bureau data show that October usage was 260,000 bales, down close to 20,000 bales from the September figure and still sharply below year-ago levels.

US exports are still running below what could be considered a recovery, but have shown a marked improvement. Average export commitments for the past four weeks have been 196,000 bales, up from the average of the previous four-week period of a paltry 107,000 bales. Contracted sales stand at only 65% of last year at this time, but that is up from less than 60% one month ago. The past two weeks saw commitments come in above trade estimates – something we haven't seen in months.

The supply side remains an overwhelmingly bullish factor. The late US harvest is no longer a factor, because we've just about caught up with the five-year average for this time of year. The weather has been cooperative, and the harvest should wrap up within days in both the Mississippi Delta and Texas.

The November USDA crop report estimated the 2009-10 US crop at 12.50 million bales, below the average guesstimate of 12.69 million bales. It seems that inclement weather did affect the crop, with the estimate for the average yield dropping significantly, to 776 pounds per acre, down from the October estimate of 807 pounds. That would be the poorest yield since 2003.

Poor weather was a large factor in China as well. Chinese production was slashed – not unexpectedly – by 1 million bales from the October estimate, to 31.5 million bales. On November 23, a US attaché report cut the estimate further, to 31.2 million bales.

As we get closer to the end of the harvest in both the US and China, we find output to be substantially smaller than forecasters had predicted just a couple of months ago.

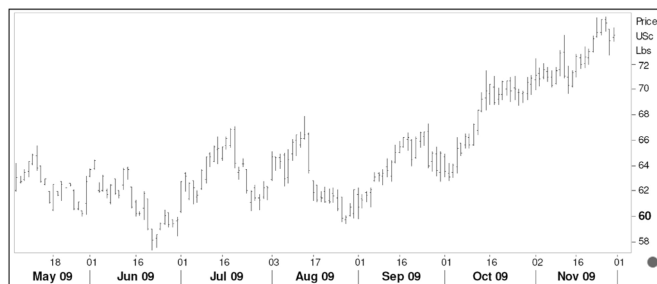
With the downward revision in global production and a 900,000-bale upwards revision to consumption, the balance sheet shows global ending stocks at 53.72 million bales, or 47.32% of consumption. This compares with the October estimate of 49.83% and 2008-09 carryover stocks of 55.81% of consumption.

On the surface, this seems to be adequate to meet what can at best be described as questionable prospects for demand growth. However, we are close to inventory levels that sparked bull markets over the past 10 years. In 2002-03 and 2003-04, carryover stocks averaged 45.7% of consumption, a period in which prices rose from 30¢ to 85¢ per pound (Chart 9). The more recent spike to 91¢ per pound in 2008 was achieved with global ending stocks at the 50%-of-usage level.

The USDA estimates Chinese domestic usage for 2009-10 at 46.25 million bales, which if accurate, would leave a production/consumption gap of 14.75 million bales, much larger than the 8.3 million bales deficit we saw in 2008-09. The USDA estimate for Chinese imports is 8.5 million bales, up just 1.5 million bales from last year. If stocks cannot be drawn on, either because of quality issues or because they don't exist, the deficit would have to be dealt with by increasing imports.

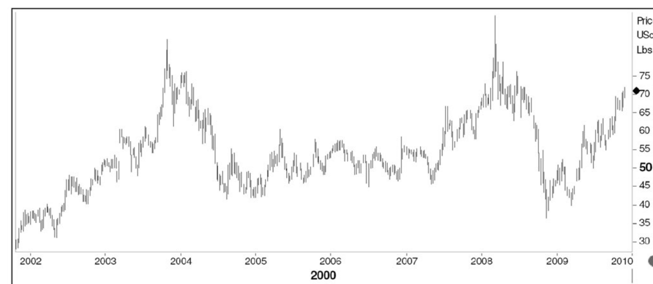
Remain long. *[December 1, 2009]*

**Chart 8 – March cotton**




*Courtesy Reuters*

**Chart 9 – Weekly cotton – nearest contract**

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## CORN

# A struggling, aging bull...but still alive

The November 10 USDA estimate for the beleaguered 2009-10 corn crop came in at 12.921 billion bushels, 19 million bushels under the average of analysts' guesstimates and 97 million bushels below the October estimate. Prices have rallied, but the reaction has been muted, with the market straining to break the topside of a two-month-old trading range (Chart 10).

We're in the midst of a booming commodity bull market, and with outside support from a weak US dollar – which has pushed the price of many commodities up to levels that are not justified by their supply/demand fundamentals – are we to conclude from market action that the bull in corn has run its course?

There are several bearish factors at work. First, animal and poultry populations have been declining and are expected to remain flat over the course of the grain marketing year. Fewer animals to feed means larger carryover stocks. The USDA estimate for US feed demand in 2009-10 is 5.4 billion bushels, up 150 million bushels from 2008-09, but still down sharply from two years ago when feed usage reached 5.9 billion bushels.

Second, natural-gas-based fertilizer represents the biggest cash cost for corn farmers. The bull markets in natural gas prices in 2005, and then again in 2008 (Chart 11), drove fertilizer prices through the roof and subsequently acted as one of the principal catalysts for the bull market in corn that saw US output fall by 7.2% in 2008-09 and corn prices shoot up to $15 per bushel (Chart 12). Now that natural gas prices have collapsed, farmers are more likely to devote more acreage to corn when they plant the 2010-11 crop this coming spring.

The prospects for much change in US domestic feed consumption, as illustrated, are negligible. The mandated 10% ethanol mix in gasoline is slated to increase to either 12% or 15% by the middle of 2010, but the USDA estimate has probably already accounted for any increase in the 2009-10 marketing year.

The USDA lowered its estimate for US exports in the November crop report by 50 million bushels, which would represent a 13% increase over 2008-09 foreign sales. This revision was understandable, because for the most part, corn sales have been absolutely dismal. Average weekly commitments have been below 500,000 tonnes, nowhere close to what we would need to meet the USDA target. Commitments to date are running only 8.5% ahead of last year at this time.

This past week, traders were surprised with combined old-crop (2009-10) and new-crop (2010-11) sales of 1.625 million tonnes, well above the high end of the range of guesstimates of 700,000 tonnes. Of course, it's meaningless if we don't see a trend develop.

Although the outlook may be bleak, we haven't really climbed out of the general structure of tightness that has plagued this market. Although the US crop is 6.7% larger than last year's, it should be somewhat startling to learn that inventories are actually forecast to fall because of the marginal demand improvements over last year. At 1.625 billion bushels, 2009-10 US ending stocks are estimated at 12.5% of projected consumption, down from last year's 1.674 billion bushels, or 13.9% of consumption. Growth of ethanol usage is the single largest change on the demand side, with the USDA estimate calling for a 500-million-bushel corn- equivalent increase from 2008-09.

Despite the tepid sales paces, one wild card is exports. US exports comprise just half of world trade. Brazil and Argentina are the only other exporters of any significance. If world trade were to return to pre-recession levels, it would not take much to draw inventories back down to uncomfortably low levels. We find it hard to believe that exports will remain as weak as they've been.

The other wild card is that we still don't have a final fix on the US crop. As of the most recent crop progress report, only 79% of the crop has been harvested, compared with 94% last year and the five-year average of 97%.

We've bumbled along with a long position since the beginning of 2009 mainly on the belief that the US farmer has not adequately addressed the matter of meeting the needs of both the traditional feed market and the relatively new fuel market. This still seems to be the case.

Remain long. Use a $3.70-per-bushel stop close, basis March. *[December 2, 2009]*


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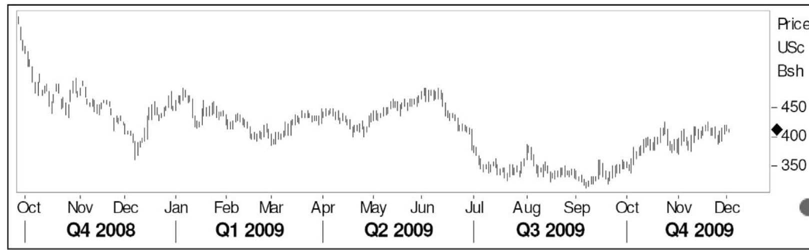
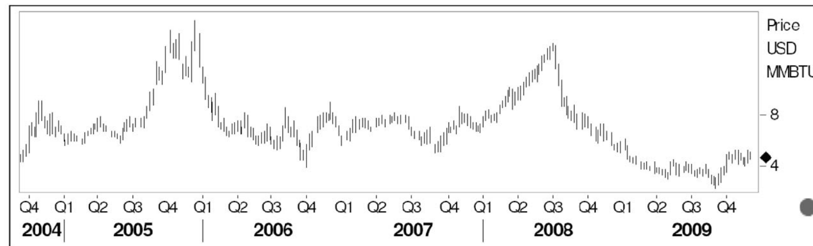
**Chart 10 – March corn**



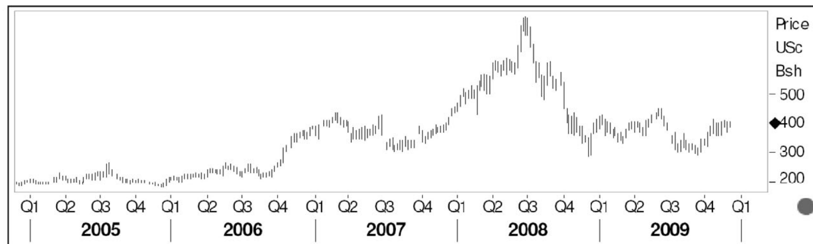

*Courtesy Reuters*

**Chart 11 – Weekly nearest contract natural gas**




*Courtesy Reuters*

**Chart 12 – Weekly nearest contract corn**




*Courtesy Reuters*

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