FRIEDBERG'S

FOCUS ON FUTURES

Friedberg Mercantile Group Ltd.

Volume 19, No. 9 December 9, 2016

Sugar: the bull takes a breather

The bull market in sugar has paused (Chart 1). Several bearish developments, we believe, triggered commodity-fund selling. The gargantuan net-long position of 290,000 contracts will take some time to unwind, but the acid test will be how well the market absorbs the selling.

China

As we've pointed out in previous issues of *Focus on Futures*, China has become an important player in the global sugar market. Earlier this year estimates for 2016-17 production were as low as 8.2 million tonnes, but more current estimates have grown to 9.3 million tonnes. That compares with 8.6 million tonnes in 2015-16. As recently as 2013-14, China produced over 14 million tonnes.

Consumption estimates vary, but all agree that demand exceeds production by a wide margin (Chart 2). Even using the low end of the range of estimates, usage is about 16 million tonnes, which has created production/consumption deficits. Imports above and beyond the 1.94-million-tonne non-tariff quota will be needed to meet demand.

The Chinese government has embarked on a program to sell sugar from reserves aggressively. But then again, those reserves have declined, to 4.8 million tonnes at the end of 2015-16 from 8.8 million tonnes in 2013-14. Even before the selling from reserves began, the estimate for 2016-17 ending stocks was just over 3 million tonnes. So even if they sold all their reserves – which they won't – they'd still be left with a supply/demand gap that would have to be filled with imports.

So while the selling of domestic reserves captured headlines and may have scared some bulls, the only solution China has for meeting demand will be to turn to the import market.

Brazil

Brazil is poised for record production of 35.2 million tonnes in the main Center South sugar region, up from 34.5 million tonnes in 2015-16. This was accomplished despite the fact that the cane crop was actually 4% smaller than in the previous season. Soaring sugar prices provided an incentive for processors to divert a greater percentage of the cane crop to sugar and away from ethanol. With the crushing season coming to a close, the ethanol/sugar ratio is estimated at 52.5%/47.5%. In recent years that ratio has been closer to 60%/40% in favor of ethanol.

This is not news, however, as these estimates have been around for many months. In fact, an item out of Brazil that the market has chosen to ignore is that the 2017-18 cane crop will actually be smaller than this year's. Normally a surge in prices of the kind we've seen in sugar would mean larger crops, but that will not happen until 2018-19. The crop that will be harvested starting in April is still expected to suffer from the years of neglect and under-investment that resulted from world sugar prices that were well below the cost of production.

India

We never believed that it was a great idea for India to be in the export market. We thought the government's compulsory export program was particularly ill advised. Output for 2016-17 is set to fall by about 1.5 million tonnes, to 23.9 million tonnes. That's actually a bit higher than some estimates we saw several months ago and may be part of the reason some traders decided to take profits.

However, we question the upward revisions to Indian output, because when you sort through some regional results, you find that recent estimates put Maharashtra, traditionally the largest producing state, at 5 million tonnes, which is 3.5 million tonnes below 2015-16. While other areas may have compensated, we are skeptical of the national estimate and

Inside

Soybeans: Crop-size illusions? 2
Cocoa: Supply-side illusions? 4
Soybean oil: Bio-diesel ignition 5

Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.

Get Focus by e-mail
Focus on Futures is available by e-mail as an Adobe PDF file. If you prefer to receive your copy of *Focus on Futures* by e-mail, please send us a message at *focus@friedberg.ca* with your full name, e-mail address, and street address.

©2016 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

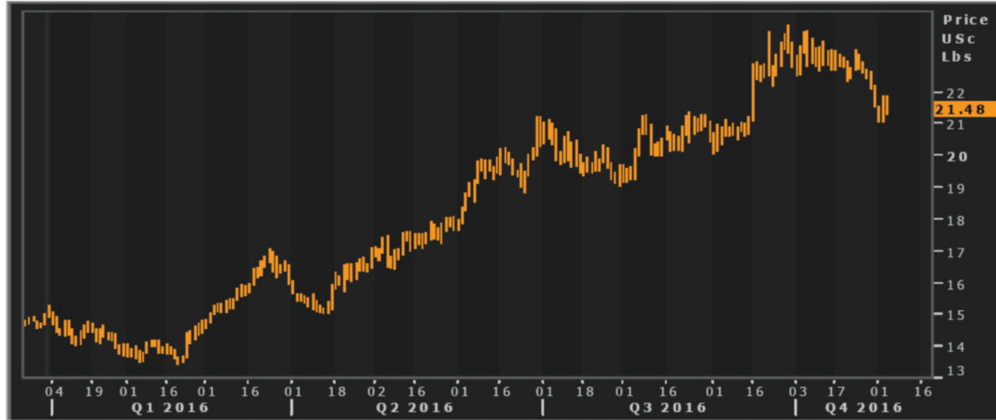
expect to see that estimate drift lower as the crushing season advances.

Estimates for the 2016-17 global production/consumption deficit are as high as 8 million tonnes. The drawdown will leave global ending stocks at roughly 18% of consumption, compared with 22% and 26% in 2015-16 and 2014-15, respectively.

Once the uncommitted longs are done liquidating, the uptrend will continue and carry this market to new highs. Remain long March 2017 22¢ call options, as per our August 10 recommendation.

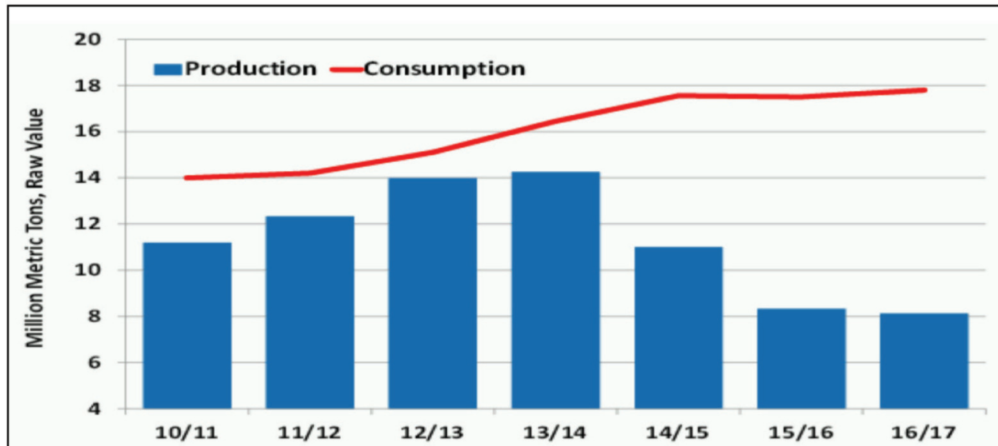
[Sholom Sanik, November 4, 2016]

Chart 1 – March sugar



Courtesy Reuters

Chart 2 – Chinese production/consumption deficit



Source: USDA

SOYBEANS

Are all the crops as large as they appear?

The November USDA crop report contained two major revisions for soybeans.

For the US, with the 2016-17 harvest just about wrapped up, all eyes were on the bushel-per-acre (bpa) yield. The estimate – already at record levels – was widely anticipated to be raised once again, which it was, but by more than expected. The average guesstimate was 52 bpa vs. the October estimate of 51.4 bpa, but the USDA came in at 52.5 bpa. There were no changes to acreage or the harvest ratio. The revision resulted in an increase in the production estimate of 92 million bushels (2.5 million tonnes), to a record 4.361 billion bushels (118.69 million tonnes).

©2016 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

Strong early-season sales pushed the export estimate up 25 million bushels, but that was mitigated by a downward revision in domestic demand of 20 million bushels.

Tucked beneath the headlines were downward revisions to 2015-16 domestic demand in a few consuming countries that amounted to an increase in the carryforward to the 2016-17 marketing year of 1.5 million tonnes.

The combination of a larger US crop and less global demand had a significant effect on the global balance sheet. It pushed the estimate for 2016-17 ending stocks up from the October estimate by 4.17 million tonnes, to 81.53 million tonnes, or 24.8% of consumption. That compares with 24.4% in 2015-16 and 26.1% in 2014-15.

The market certainly had a bearish reaction to the report. Prices are trading at the low end of the recent consolidation, but did not really plunge on the news. We believe that there are some key issues that have not been addressed.

First, the upward revision to US exports may have been canceled out by lower domestic demand, but the USDA estimate for 2016-17 total sales is materially understated, and there should be several upward revisions to follow. The USDA forecast for the marketing year is 55.79 million tonnes, 5.9% above 2015-16. But export commitments for the marketing year that began in September have already reached 37.1 million tonnes, 27.5% higher than this time last year.

Then there is the matter of South American crops. The USDA is forecasting a record Brazilian crop of 102 million tonnes, up from 96.5 million tonnes in 2015-16. The estimate is based on planted area and a quick planting pace. Over 30% of Brazilian output comes from the southern part of the country, an area that is most vulnerable to La Niña-related drought. Large swings between early forecasts and final output in Brazil are not uncommon. So it is a bit early to be overly optimistic when there is a specific weather-related threat overhanging.

The USDA maintained its forecast for Argentina at 57 million tonnes, up slightly from last year's output, but we believe that this estimate is curiously well behind recent developments. For starters, planted area is down 2.5% from 2015-16, mostly because farmers are shifting more area to corn, which has become more profitable since the new government repealed the export tax.

In addition, unlike Brazil, planting the new crop has been slow because of wet weather. In mid-October the USDA *attaché* lowered its estimate to 55 million tonnes. One private forecast puts the output estimate at 52.5 million tonnes.

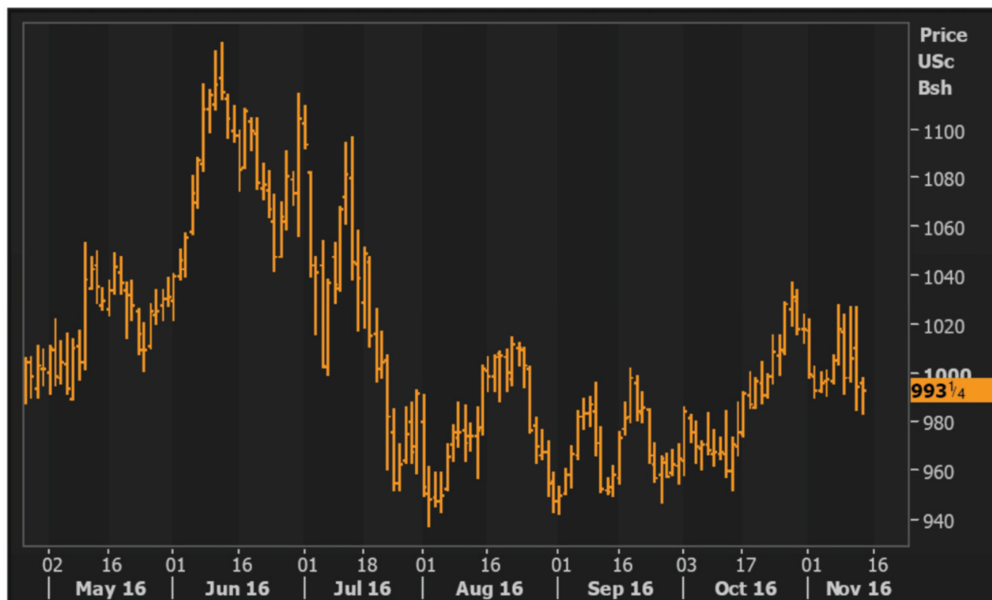
We therefore believe that upward revisions to demand and downward revisions to supply are inevitable. This would explain why soybean prices have not made much downside progress after what was ostensibly a very bearish report.

We were incorrectly skeptical of the constantly improving outlook for both US soybean and corn yields. While this month's yield estimates may not be final, they are close enough. Nevertheless, as long as demand continues as strong as it's been and the USDA's exuberance regarding South American crops turns out to be wrong, we can see much higher prices.

Buy March soybeans. Place initial sell stops at $9.40 per bushel, close only.

[By Sholom Sanik, November 15, 2016]

Chart 3 – March soybeans



Courtesy Reuters

©2016 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

COCOA

A slow start for West African crops – time to run for cover?

Cocoa prices have plunged to three-year lows (Chart 4).

A cursory examination of the supply side could lead to conclusions that the market is oversold. The Ivory Coast grows roughly 35% of the world's cocoa beans. After several years of bumper crops, the 2015-16 season (October through September) was an off year. Port arrivals fell to 1.566 million tonnes, down from 1.8 million tonnes in 2014-15.

Arrivals for the new 2016-17 marketing year got off to a slow start due to early-season dryness. In early November, main-crop arrivals were close to 20% behind last year's pace. The most recent data, however, show that arrivals have been catching up and are now only 7% behind last year. Of note, early season results mean very little. Last year at this time arrivals were ahead of the previous season's, and then they fizzled.

As indicated, the weather has not been perfect, but there has been some rain, and subsoil moisture levels are healthy. Arrivals are expected to pick up steam in the coming weeks. The wild card is the intensity of the December-through-March harmattan winds that come down from the Sahara and move through the region. A strong harmattan will bring dryness and reduce yields. Forecasts call for a mild episode this year, but it remains a vulnerable factor.

A similar pattern has emerged in Ghana, the world's second-largest producer. Reporting is not nearly as organized as it is for the Ivory Coast, but from incidental information, we estimate that output has reached just over 200,000 tonnes. That is sharply below last year at this time. Like the Ivory Coast, 2015-16 was an off year, with production reaching only 770,000 tonnes. But weather permitting, output could bounce to 850,000 tonnes, which would be closer to what Ghana produced in previous years.

Rounding out West African production, Nigeria and Cameroon have had a slow start to their 2016-17 season as well, and are also likely to benefit – or suffer – from the strength of the harmattan winds.

Shifting over to the demand side, third-quarter grind data for non-origin grinding nations were mixed. Europe was up 2.9% year-over-year, but North America showed a meager 0.15% gain.

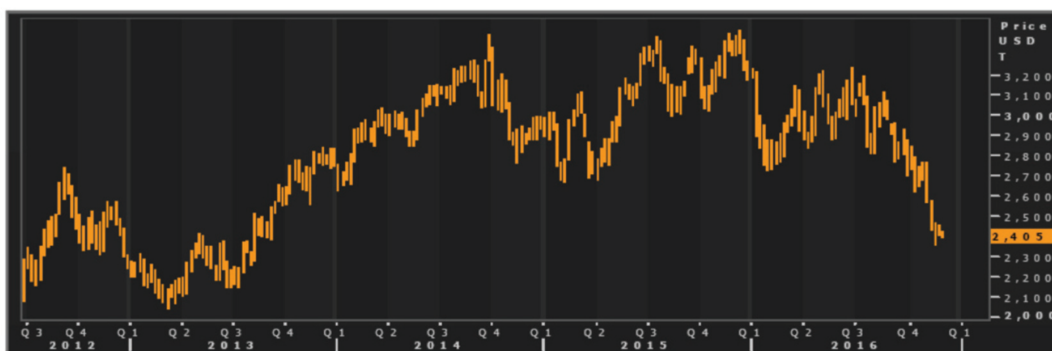
Some evidence exists to support the theory that grinding has been lethargic in traditional processing nations because activity is slowly shifting over to origin countries. Asian grindings have increased by about 3% over the past year. Then again, while it may be true that processing capacity has increased in West Africa, actual grinding has not. For the recently concluded 2015-16 marketing year, Ivorian grinding was down 9%. But even with the poor showing in the Ivory Coast, we have to take into account that there were simply fewer beans to grind because of the smaller crop.

Nevertheless, demand – at least to the extent that grinding is considered an accurate barometer – has been disappointing. There are plenty of beans kicking around in Europe – ending stocks are estimated at about 33% of consumption. The incentive of higher butter prices was ineffectual. Butter prices have moved to multi-year highs, but powder prices have dragged down the overall profitability of grinding. Chart 5 shows the combined butter/powder ratio – which measures the profitability of grinding beans – has dipped.

Commodity funds have been long this market since 2012 (Chart 6). That net-long position is all but gone, but we believe that there is far more depth to this bear market than stale long liquidation. Remain short. Lower protective buy stops on March cocoa, from $2,950 per tonne recommended on October 14, to $2,700, close only.

[By Sholom Sanik, November 29, 2016]

Chart 4 – March Cocoa



Courtesy Reuters

©2016 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

Chart 5 – Combined cocoa butter/powder ratio

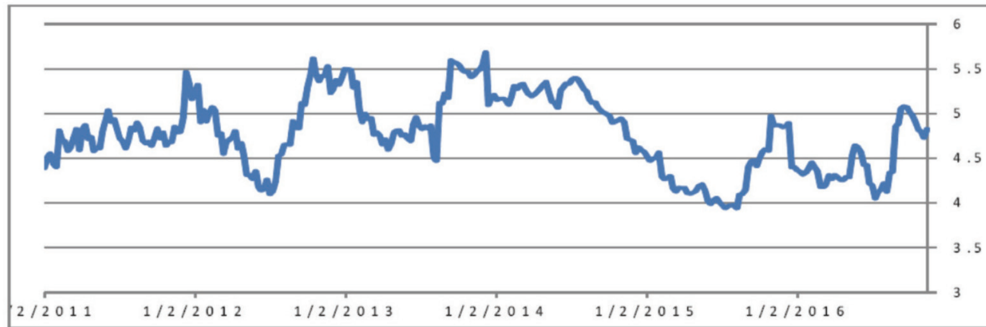
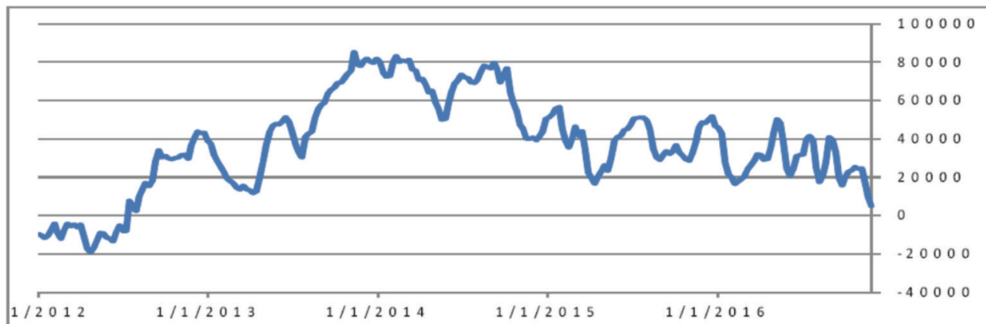


Chart 6 – CFTC commodity fund net position



SOYBEAN OIL

Bio diesel ignites already-hot soybean oil

Soybean oil is trading at two-and-a-half year highs. Prices of other major vegetable oils – such as palm and canola – are trading at or near multi-year highs as well (Charts 7, 8 and 9).

After several years of strong gains in global production, vegetable oil output for the 2015-16 marketing year was flat. This was the result of El Niño-induced drought in Southeast Asia, which lowered palm oil yields in Indonesia and Malaysia.

Fears of lingering dryness have turned out to be unfounded, and output is expected to rebound sharply in 2016-17. Production in Indonesia and Malaysia is forecast to rise to 40 million tonnes and 22.5 million tonnes, respectively, an increase of about 10% over the previous season. In the case of Indonesia, that would be record production.

Production in all other major vegetable-oil-producing regions – with the exception of the European Union – is forecast to reach record levels as well. So why the soaring prices? There are two reasons:

First, global vegetable oil output is forecast to rise 4.86% in 2016-17 against an increase of only 3.27% for consumption. But ending stocks will continue to be drawn down regardless because of the dismal output performance and surge in demand in 2015-16.

Unlike other internationally traded grain and oilseed markets, ending stocks have been dwindling. They peaked in 2013-14 at 13.9% of usage. For 2015-16, they fell to 10.9% and, based on current USDA estimates, are slated to fall a modern-history low of 9.8% in 2016-17.

Then, on November 23 the US government provided a further boost for this market. The Environmental Protection Agency (EPA) announced that it is increasing the required renewable fuel volume for 2017 by 6%. That includes a 100-million gallon increase for biomass-based diesel – manufactured in the US primarily from beanoil – twice the amount of the minimum congressional target.

That news sparked a 2.5¢-per-pound, or 7%, rally in beanoil, the largest one-day move in years. And the market has been building on that spike since.

Traditionally, beanoil takes its cue from movements in the much larger palm oil market. This time, it was the reverse. Palm oil prices, which had already broken out of a trading range prior to the EPA news, continued to rally. Both markets are 8% higher since the new EPA mandate hit the news wires.

The advance of vegetable-oil based diesel fuel mandates is not limited to the US. Governments of countries from India

©2016 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

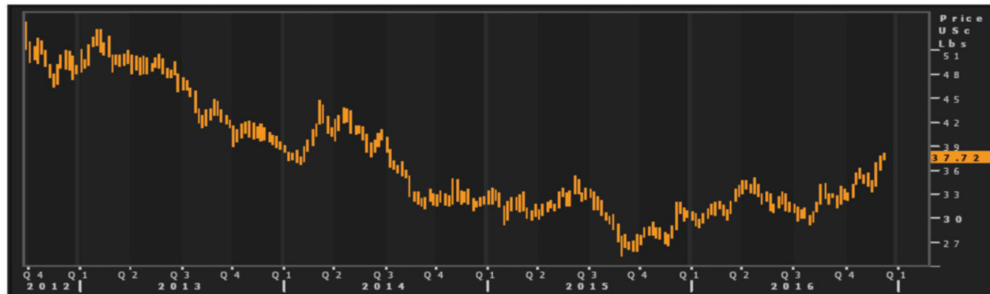
to Indonesia have created incentive for processors to divert ever-increasing amounts of oil away from food to fuel.

To get an idea how the beanoil-based bio-diesel program has developed in the US, consider that in the 2009-10 marketing year, only 9% of beanoil produced in the US was used for fuel. In 2014-15 and 2015-16 that ratio rose to 24% and 25.3%, respectively. The USDA estimate in the November crop report before the EPA raised the requirements was 26.3% of total usage. This evokes memories of the bull market in corn in the last half of the 2000s, which was underscored in no small part by the explosive growth in the corn-based ethanol market.

Remain long March soybean oil as per our August 31 recommendation. Raise stops from 29.5¢ per pound, basis the nearest contract, to 33.5¢, close only.

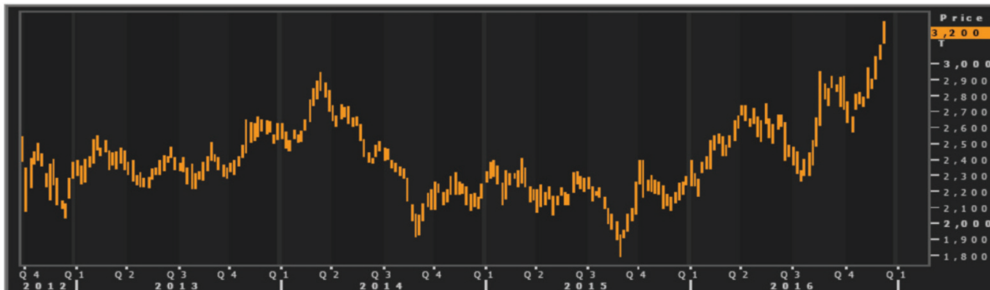
[By Sholom Sanik, December 8, 2016]

Chart 7 – CBOT soybean oil – weekly nearest contract



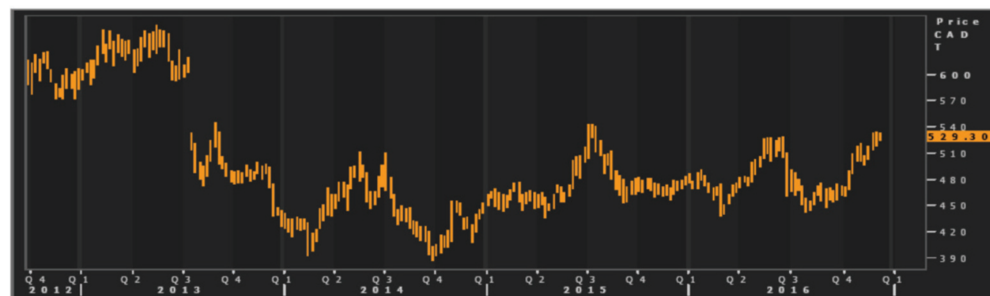
Courtesy Reuters

Chart 8 – Malaysian palm oil – weekly nearest contract



Courtesy Reuters

Chart 9 – ICE canola oil – weekly nearest contract



Courtesy Reuters

Friedberg's Focus on Futures is published by Friedberg Mercantile Group Ltd., P.O. Box 866, Suite 250, 181 Bay Street, Toronto, Ontario, M5J 2T3. Contents copyright © 2016 by Friedberg Mercantile Group Ltd. All rights reserved. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with due acknowledgement. Friedberg Commodity Management Inc., an NFA registered CTA, takes full responsibility for the contents of this publication.

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:
Friedberg Mercantile Group Ltd.
Suite 250
181 Bay Street
Toronto, Ontario M5J 2T3
416-350-2903
Attn: Sholom Sanik

Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits. This report is a solicitation for entering into a derivatives transaction. The author of this report may have a position in the underlying derivative securities mentioned in this report.
The information in this report was obtained from sources we believe to be reliable but is not guaranteed by Friedberg Mercantile Group Ltd. or its affiliates.
Derivatives are high-risk investments, and there can be no assurances that the securities mentioned or recommended will maintain their value at a constant amount or that the full amount of your investment will be returned to you. Derivatives' values change frequently and past performance may not be repeated.