FRIEDBERG'S
FOCUS ON FUTURES

Friedberg Mercantile Group Ltd. Volume 7, No. 2 March 1, 2004

Are $9 beans justified?

Soybean prices have soared through the $9-per-bushel level, a seven-year high. The market was weak in January, but shook off a number of potentially bearish developments, roaring back with a $1.50-per-bushel rally since the beginning of February.

Over the past several months the discovery of bird flu in Asia has dominated soybean and corn headlines and has been the primary market mover at times. This news inspired fears among bulls that feed demand would fall.

Between flock liquidations and the cancellation of poultry shipments by importing countries, the system did back up to some degree. Short-term usage was affected and may continue to be, especially in specific regions where the virus was discovered. Any broad impact on feed usage, however, is more perception than reality.

There is no good reason to expect that the timely measures being taken by authorities in the regions where the virus is popping up will not contain the situation. The amount of feed usage that will be lost is insignificant in the long run and is dwarfed by the steadily increasing growth in global usage of soy and other animal feed.

While the market is flying high, perhaps it pays to draw attention to some sobering issues. In its February report, the USDA offered a somewhat different picture of the global supply demand balance than we've become accustomed to this marketing year. Global ending stocks were revised upwards by 1.5 million tonnes, to 37.47 million tonnes, because of a further upward revision of 1 million tonnes to the estimate for the Brazilian crop and an increase in last year's Brazilian ending stocks of just over 500,000 tonnes. This will bring the 2003-04 carryover up to 18.6% of consumption, compared with 17.9% last month and 20.6% at the end of last season.

There were no revisions for the US. Ending stocks for 2003-04 remain at a dangerously low level of 3.41 million tonnes. Crush margins in the US remain very high, which means that crushers still have a strong incentive to purchase beans for processing. The rationing process, which is expected to push bean prices to levels that will discourage crushing, does not seem to be getting off the ground. And that means supplies should continue to tighten.

While demand remains strong in the domestic market, the export market has shown signs of strain. Exports have been the driving force behind the bull market, but have clearly tapered off. As recently as early January, 2003-04 US export commitments were running 1.7 million tonnes, or 8.5%, ahead of the previous season's sales. Since then, however, the pace has dropped off considerably with weekly sales averaging only 177,000 tonnes, compared with 527,000 tonnes during December. We have now slipped *behind* last year's pace by 1.2 million tonnes, or 5%.

Those figures don't tell the whole story, though. The numbers don't necessarily translate into a sudden shift in fortunes for US exporters. Rather, China has been switching 2003-04 commitments to 2004-05. The Chinese haven't actually cancelled any commitments – they've pushed them forward to new-crop. Total new-crop sales to China stand at just over 2 million tonnes. Last season, new crop sales for all countries did not reach that level until July.

So while China has technically lived up to promises made by its touring soybean delegation, the events as they have unfolded should be of at least some concern to bulls. The urgency displayed by the continual stream of large purchases last year seems to have dissipated. By delaying shipments to November or later, it appears that the well-publicized announcement was more political positioning than an indication of demand. China's import needs may be covered

Inside

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

for the time being.

A popular theory being touted is that the urgency indeed persists, but that China and other Asian customers are merely shifting to South American beans as Brazil and Argentina prepare to harvest yet another set of record crops. The available evidence, however, does not support this.

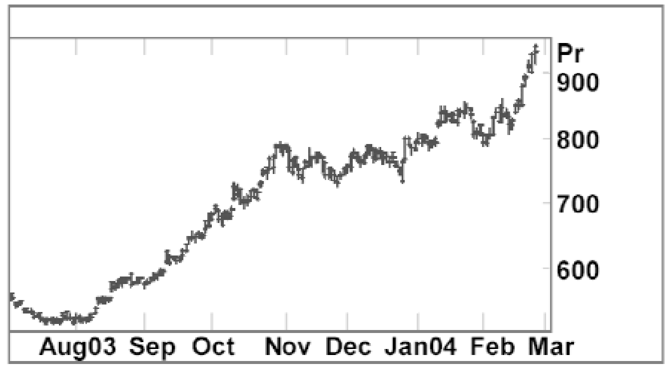
Brazilian export registrations – the equivalent of our export commitments – show that Brazilian exporters have booked 8.03 million tonnes of soybean sales so far this season, compared with 8.33 million tonnes at the same time last year. The USDA is forecasting Brazilian output at 61 million tonnes, an 8.5-million-tonne increase over last year, and exports of 26.6 million tonnes, a 6.2-million-tonne jump over the previous season.

With registrations running slightly behind last year's, one would have to observe that the 2004 campaign did not get off to a very good start. This leads us to conclude that the rampant buying we witnessed earlier in the US marketing season may have left principal Asian customers well supplied for the moment.

With the market making fresh contract highs daily, it is a challenge to take a negative view of this market. Commodity markets are cyclical, though, and we don't know of any bull or bear market in history that has not ended in oversupply or shortage. China's pushing its US commitments forward and its tepid interest in Brazilian beans may be an indication that a top in beans is near. *[February 26, 2004]*

STRATEGY: *Remain sidelined.*

Chart 1 – March soybeans



Courtesy Reuters

COCOA

Duped again!

For the second consecutive season, cocoa market participants have been working with erroneous information. Political unrest in the Ivory Coast, the world's largest cocoa producer, was expected to result in a labor shortage as migrant workers fled back to their native countries. It was feared that supply routes leading from plantations to ports would be compromised. According to press reports, these output reducing factors would cut the amount of 2003-04 supply available for shipment. Main crop arrivals, which began to appear in November and December, ran significantly behind the previous year's pace, and prices rallied about $400 per tonne to match 2003 highs of $1,750 per tonne.

Subsequently, arrivals slowly began to catch up to normal levels, and prices started to fade. On February 19, the first credible summary of the 2003-04 global supply/demand balance we'd seen in some time was released and confirmed that fears of a reduced crop in the Ivory Coast were completely unfounded. Credit Lyonnais Rouse (CLR) increased its estimate of Ivorian output by 50,000 tonnes from its previous report. Output should reach 1.32 million tonnes, only 20,000 tonnes shy of 2002-03 production of 1.34 million tonnes.

As the arrival season wears on, it is becoming increasingly clear that the crop is in fine shape. On February 23, arrival data had reached 886,000 tonnes, compared with 937,000 tonnes at the same time last year. With the prospects of an excellent mid-crop, which is likely to be somewhat larger than the previous season's, all available hard data are completely consistent with CLR's estimate.

Global output is expected to grow by 26,000 tonnes, or by less than 1%, to 3.105 million tonnes. The world's second largest producer, Ghana, will produce about 500,000 tonnes, roughly the same as last year. Indonesia, the number three grower, will see a sharp jump in output to 460,000 tonnes from 386,000 tonnes.

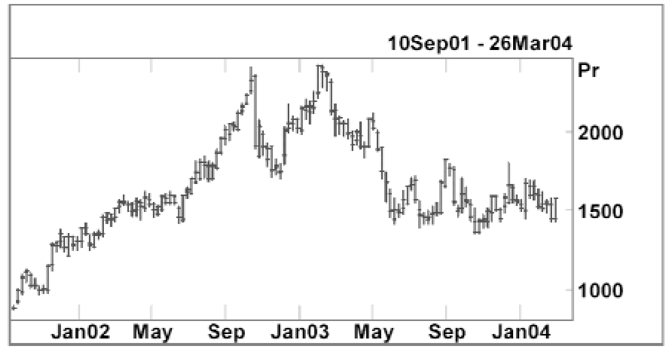
So why hasn't the market fallen apart? Yes, we're much closer to the bottom of the past year's range than we are to the top. But after two years of showing the cocoa world that the plantation and shipping infrastructure in the Ivory Coast is solid enough to withstand chronic civil unrest, there should be little need for a fear premium.

The answer lies on the demand side. Consumption was weak early this decade, but CLR estimates that after last season's 4.9% increase, world grindings will rise again in 2003-04 by 4.3%, to 3.106 million tonnes. Consequently, although we're looking at a record world crop, we're still going to be left with a supply/demand deficit of 32,000 tonnes. (Gross production is reduced by 1% for weight loss when calculating the world balance). Ending stocks are estimated at 41% of consumption, compared with last year's 44% and a 2001-02 carryover of 43%. From a historical perspective, these inventory levels are not necessarily considered bull market territory, but the trend of a tightening world supply/demand balance cannot be ignored.

The information available on butter ratios is somewhat sketchy, but from data we have seen, it seems that the ratio has slipped below 2 times London futures recently. This ratio had been over 2 for the past few months, but is still considered profitable enough to keep grinding facilities operating at capacity, which of course keeps demand for beans strong. For most of last year, the ratio hovered between 1.5 and 1.75.

As for what direction prices will take from here, the balance of evidence is inconclusive. Traders anticipated an extraordinary event on the supply side, but at this point, it is a given that the Ivorian crop and the crops of the other major producers will be of average size or better. On the other hand, we have to deal with the fact that consumption is growing at a better-than-expected pace. Now that a full-size Ivorian crop is in the market, we believe that the swing factor will be demand. Because demand is definitely in an uptrend, we have a slight bias to the bullish side, but remain sidelined for the moment. *[February 27, 2004]*

Chart 2 – Nearest month cocoa



Courtesy Reuters

STRATEGY: *Stay tuned.*

SUGAR

Can sugar be getting sweeter?

After trading dangerously close to the 5¢-per-pound level and threatening to take out multi-year lows earlier this month, sugar prices sprinted back over the past couple of weeks with a handsome rally (Chart 3). Was it some short-covering before the March expiry or the beginning of something bigger? We're going to suggest that it's combination of both.

Clearly, the bear market was well warranted. With slight variances among analysts, the final tally for the 2002-03 season saw an enormous global production/consumption surplus of over 10 million tonnes. Even before the major world crops were anywhere near complete, we knew that consumption had grown at least enough to avoid repeating a burdensome surplus this season. Now that we're getting a better look at the crops as they near completion, we find that there will be another surplus, but the world balance is tightening up.

First, on February 12, Czarnikow released an updated forecast in which it lowered its estimate for the 2003-04 global production/consumption balance to 1.15 million tonnes from a surplus of 1.32 million tonnes in its November estimate. Indeed, this is small change. However, we can distinctly remember other environments in the sugar market in which a series of small, seemingly insignificant revisions in the global balances allowed us to identify major turning points. When statistics show an over- or under-supplied market and prices seem commensurate with the fundamentals, it is difficult to envision a turnaround. However, by the time the statistics are bullish enough for the financial press to report on, you have missed it.

On February 25, E.D.&F. Man weighed in with its latest report and confirmed the trend of a shrinking 2003-04 surplus. It lowered global production by just over 1 million tonnes and increased consumption by 500,000 tonnes from its November estimates. This resulted in a revised surplus of 2.2 million tonnes, down from the November estimate of 3.66 million tonnes.

The principal components of the revisions come from China and India. E.D.&F. Man raised its estimate for Chinese consumption by close to 300,000 tonnes, to 11.5 million tonnes. In last month's *Focus on Futures* we wrote about Chinese consumption of 10.5 million tonnes. With a crop that is estimated to be under 10 million tonnes, China is starting to run some serious deficits which will force it either to draw down inventories, which may or may not be sufficient to meet its needs, or to turn to the export market in a much bigger way than we've seen in years.

Indian output is expected to drop sharply from last year's bumper crop of over 20 million tonnes, because the monsoons were weaker than normal. Estimates vary wildly on how much smaller the crop will be, with one local analyst saying that the crop will reach only 15 million tonnes. Other, more moderate estimates call for a loss of 2 million tonnes from last year. Either way, it is a bullish development because India has been carrying large stocks.

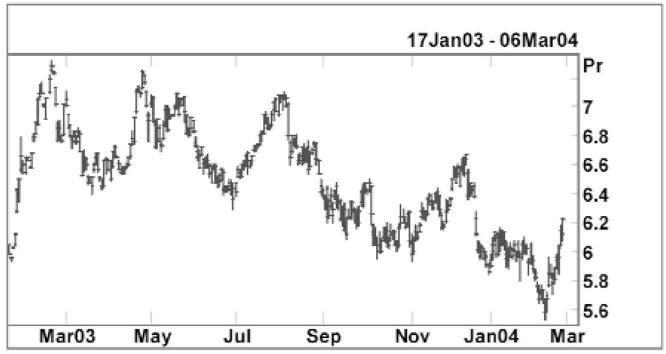
The threat of India reducing those stocks with a serious entry into world trade has hung over the market for some time. Its domestic needs are estimated at 21.5 million tonnes. Even if the crop reaches 18 million tonnes, it will have to draw down stocks, making it an unlikely participant in the export market any time soon.

Commodity funds have been building a large short position for many months. Last week's Commitment of Trader data show that their net-short position shrank by about 9,000 contracts, which still leaves them net-short over 50,000 contracts. This week's rally probably saw more short covering, but a glance at Chart 3 certainly seems to indicate that we have a good old-fashioned bear trap in the works.

In conclusion, one can't say that the fundamentals are bullish. They're not. Even after the revisions mentioned above are accounted for, global ending stocks are still about 48% of consumption. We can say, however, that the fundamentals are definitely less bearish than they've been. The market is very oversold when it is trading near historic lows with a global supply/demand surplus that has dropped significantly from its historic highs. If the Chinese and Indian situations play out to a worst-case scenario, we could easily move into a deficit position. *[February 27, 2004]*

STRATEGY: *Stay tuned.*

Chart 3 – May sugar



Courtesy Reuters

WHEAT

China goes on a shopping spree

Soybean and corn prices settled at fresh contract highs this past week. Wheat prices, while still perched near their highs, have languished below their peak set back in early December (Charts 4, 5 and 6). One can't help but wonder whether the weakest link in the group is being kept afloat by the general bullish mood in the Chicago Board of Trade agricultural pits.

Wheat prices found some support recently from several large Chinese purchases. In addition to the 1.185 million tonnes of commitments already booked for the current marketing year and 1.06 million tonnes for 2004-05 delivery, the USDA announced last week that China bought 900,000 tonnes this past week. Shipment will be divided between old- and new-crop delivery. All told, China has booked 3.145 million tonnes of US wheat for 2003-04 and 2004-05. A complete breakdown of delivery dates for the most recent purchase was not provided, but we know that at least 1.34 million tonnes is scheduled for shipment before the US marketing year ends on June 1.

In its January supply/demand situation report, the USDA revised total Chinese 2003-04 imports from all origins upwards, to 2 million tonnes, from 1 million tonnes and made no further revision in its February report. In December China bought 1 million tonnes of wheat from Australia and 500,000 tonnes from Canada, some of which is for near-term delivery.

China's status as a significant importer is a new wrinkle in the wheat market. As we detailed in the December issue of *Focus on Futures*, China has not been a consequential buyer of foreign wheat since the mid-1990s. The USDA has maintained its tradition of easing slowly into dramatic changes. We're taking an educated guess that the USDA will have to revise its estimate for total Chinese exports higher once again before the end of the marketing year, which will tighten the global balance sheet further.

Even before news of the most recent large Chinese purchases of US wheat were known, the February USDA report tightened the screws on carryover stocks. A series of revisions to the estimates of major producers' crops and a small uptick in consumption drew the estimate for global ending stocks down to 125.95 million tonnes, or 21.3% of consumption. This compares with last month's 21.5%, last year's 27.5%, and 34.3% in 2001-02.

Part of the reason for the sluggish action in the wheat market is the outlook for global new-crop output. On February 26, the International Grain Council (IGC) released its February report, which showed global production would reach 601 million tonnes in the 2004-05 marketing year, up from 557 million tonnes in 2003-04. This was not real news, because the IGC was simply confirming last month's estimate. The 557-million-tonne estimate for 2003-04, however, represented a 3-million-tonne upwards revision.

Global wheat output has been in decline since the 1998-99 season, when production peaked at 610 million tonnes. Since then, a combination of crop failures in major producing countries in some years and the disincentive to farmers resulting from low prices in others has kept wheat output in a precipitous downtrend. Consumption did not skyrocket the way it did for animal feed grains during this period, but remained steady and large enough to draw global ending stocks down to historically low levels, as illustrated above. Ideas that the trend of shrinking world crops is about to break have understandably cast a bearish pall over the market.

The Chinese buying spree and the outlook for bigger crops are the primary issues at present. Last year at about this time, when early forecasts for global production were beginning to surface, all the major blue-chip analysts were talking about a world crop of over 600 million tonnes. Of course, they could not possibly predict the weather and the many other factors that affect crops. But, boy, were they wrong!

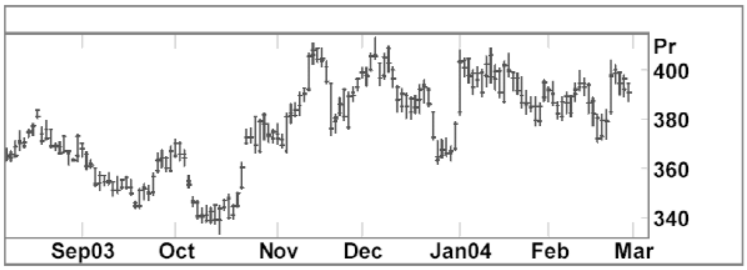
We are therefore taking a more simplistic view and will invoke a we'll-believe-it-when-we-see-it approach. What we do know is that US winter wheat acreage is smaller than last year and smaller than analysts had been expecting. Chinese acreage is significantly smaller because farmers are switching to more profitable cotton and soybeans.

One bright spot for the bear case is Australia's recovery to a 25-million-tonne crop. This was an impressive achievement, and we were certainly wrong in that area because we were very skeptical about its return to normal crop size after a dismal 10 million-tonne-crop in 2002-03.

We maintain a bullish bias. Until it becomes clear that the rather aggressive production forecasts for 2004-05 are plausible, we can't really see the bearish case. Chinese buying is no longer a theory, but a reality. If the USDA's estimates of the rapid fall in China's ending stocks over the past few years are anywhere near accurate, we should see a continuous flow of Chinese buying, further tightening of global ending stocks, and higher prices at the end of the day. *[March 1, 2004]*

STRATEGY: *Stay tuned.*

Chart 4 – May wheat

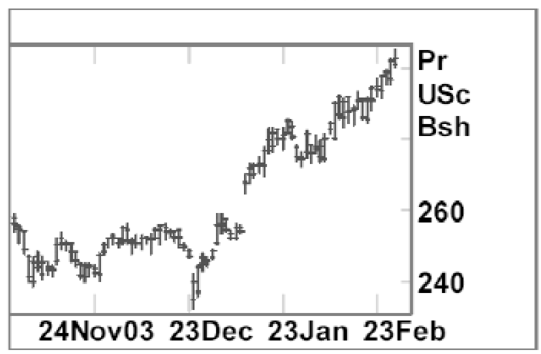


Courtesy Reuters

Chart 5 – May soybeans

Courtesy Reuters

Chart 6 – May corn



Courtesy Reuters

HOTLINE UPDATE

***Flash Update* – Thursday, January 29, 2004:**
Good morning for Thursday, January 29, 9:30 am. This is a Flash Update. We have rolled over our long February gold position into April.

***Flash Update* – Thursday, January 29, 2004:**
Good afternoon for Thursday, January 29, 1:45 pm. This is a Flash Update. We have liquidated our long April gold position at 399.10.

***Flash Update* – Thursday, January 29, 2004:**
Good afternoon for Thursday, January 29, 2:50 pm. This is a Flash Update. We have liquidated our long March cotton position at 68.40. We repeat our Flash Update of earlier today, where we liquidated our long April gold position at 399.10.

***Flash Update* – Friday, January 30, 2004:**
Good morning for Friday, January 30, 11:45 am. This is a Flash Update. We have purchased March sugar at 5.87, placing our initial stop at 5.00, close only.

Friday, January 30, 2004:
Good afternoon for Friday, January 30, 4:30 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels: On January 29, we liquidated our long gold position at 399.10, and liquidated our long March cotton position at 68.40; on January 30, we purchased March sugar at 5.87.

We are currently long March sugar at 5.87, with our initial stop at 5.00; and long March Japanese yen at 9171, with our stop at 8980. All stops are close only.

HOTLINE UPDATE (continued)

***Flash Update* – Thursday, February 5, 2004:**
Good morning for Thursday, February 5, 9:15 am. This is a Flash Update. We have purchased March Canadian dollars at 74.85, placing our initial stop at 74.00, close only.

***Flash Update* – Friday, February 6, 2004:**
Good morning for Friday, February 6, 11:30 am. This is a Flash Update. We have purchased May cocoa at 1548, placing our initial stop at 1425, close only.

***Flash Update* – Friday, February 6, 2004:**
Good afternoon for Friday, February 6, 12:05 pm. This is a Flash Update. We have liquidated our long March sugar position at 5.43. We repeat our Flash Update of earlier today where we purchased May cocoa at 1548, placing our initial stop at 1425, close only.

Friday, February 6, 2004:
Good afternoon for Friday, February 6, 3:40 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels: On February 5, we purchased March Canadian dollars at 74.85; on February 6, we purchased May cocoa at 1548, and liquidated our long March sugar position at 5.43.

We are currently long May cocoa at 1548, with our initial stop at 1425; long March Japanese yen at 9171, with our stop at 8980; and long March Canadian dollar at 74.85, with our initial stop at 74.00. All stops are close only.

Monday, February 9, 2004:
Good morning for Monday, February 9. We have sold short March mini S&P at 1140, placing our initial stop at 1160, close only.

Friday, February 13, 2004:
Good afternoon for Friday, February 13, 3:40 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels: On February 9, we sold short March mini S&P at 1140.

We are currently long May cocoa at 1548, with our stop at 1425; long March Japanese yen at 9171, with our stop at 8980; long March Canadian dollar at 74.85, with our stop at 74.00; and short March mini S&P at 1140, with our initial stop at 1160. All stops are close only.

***Flash Update* – Friday, February 20, 2004:**
Good morning for Friday, February 20, 11:45 am. This is a Flash Update. We have liquidated our long May cocoa position at 1450.

***Flash Update* – Friday, February 20, 2004:**
Good afternoon for Friday, February 20, 12:50 pm. This is a Flash Update. We have liquidated our long March Canadian dollar position at 74.35. We repeat our Flash Update of earlier today, where we liquidated our long May cocoa position at 1450.

Friday, February 20, 2004:
Good afternoon for Friday, February 20, 3:40 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels: On February 20, we liquidated our long May cocoa position at 1450, and liquidated our long March Canadian dollar position at 74.35.

We are currently long March Japanese yen at 9171, with our stop at 8980; and short March mini S&P at 1140, with our stop at 1160. All stops are close only.

***Flash Update* – Thursday, February 26, 2004:**
Good morning for Thursday, February 26, 9:30 am. This is a Flash Update. We have purchased April gold at 396, placing our initial stop at 378, close only.

Friday, February 27, 2004:
Good afternoon for Friday, February 27, 3:55 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels. On February 26, we purchased April gold at 396.

We are currently long March Japanese yen at 9171, with our stop revised to 9080; short March mini S&P at 1140, with our stop at 1160; and long April gold at 396, with our initial stop at 378. All stops are close only.

Friedberg's Focus on Futures is published by Friedberg Mercantile Group Ltd., P.O. Box 866, Suite 250, BCE Place, 181 Bay Street, Toronto, Ontario, M5J 2T3.

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

For U.S. Persons
Friedberg Mercantile Group, Inc.
Suite 250, BCE Place
181 Bay Street
Toronto, Ontario, Canada M5J 2T3
1-800-461-2700